

# **PART II**

# PART II

## ACCOUNTS AND OPERATIONS OF THE CENTRAL BANK OF SRI LANKA

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## 1. ACCOUNTS AND FINANCE

### **Central Bank of Sri Lanka Management Statement For the period ended 31 December 2012**

#### **Accountability and the Financial Performance of the Central Bank of Sri Lanka in relation to the Objectives**

The Central Bank was established as the authority responsible for the administration, supervision and regulation of the monetary, financial and payment systems of Sri Lanka under the Monetary Law Act. In accordance with this Act, the Bank is charged with the responsibility of securing the core objectives of economic and price stability and financial system stability.

The basis of accountability for the Central Bank and the success of its operations therefore would be the effectiveness of its policies and operations leading towards the achievement of its core objectives and not necessarily its profitability. These statutory objectives are the fundamental features that distinguish the Central Bank from any other entity, private or public. Accordingly, profitability related approach, if adopted by the Central Bank, could result in the Bank pursuing profits while compromising its core objectives, since it has the unique ability to create its own profits through its monetary policy activities, which could influence interest rates and exchange rates. It therefore

follows that the Central Bank's objectives of economic and price stability and financial system stability need to be distinguished and detached from the pure profitability objective which should essentially be incidental or academic only.

In this background, the Central Bank's financial statements record gains and/or deficits in the implementation of its monetary policy operations, exchange rate management, issuing of currency, etc. at the values as realized and hence, the financial performance as reported in these statements needs to be interpreted and understood in that context.

The Bank is subject to an external audit by the Auditor General under the Monetary Law Act sections 42 & 43. The Auditor General in turn has obtained the services of a firm of Chartered Accountants M/S Ernst & Young to carry out an audit under International Standards of Auditing to ensure compliance with the International Financial Reporting Standards.



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**கணக்காய்வாளர் தலைமை அறிப்பி நினைக்களம்**  
**AUDITOR GENERAL'S DEPARTMENT**



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 துலைவா } FB/K/CBSL/FA/2012  
 My No }

මගේ අංකය }  
 உமது இல }  
 Your No. }

දිනය }  
 திகதி } 15 March 2013  
 Date }

The Honourable Minister of Finance

**Report of the Auditor General on the Financial Statements of the Central Bank of Sri Lanka (CBSL) for the year ended 31 December 2012 in terms of Section 42(2) of the Monetary Law Act (Chapter 422)**

The audit of the financial statements of the Central Bank of Sri Lanka for the year ended 31 December 2012 comprising the statement of financial position as at 31 December 2012 and the Income Statement, Statement of Comprehensive Income, Statement of Changes in Equity and Cash Flow Statement for the year then ended and a summary of significant accounting policies and other explanatory 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 Section 13(1) of the Finance Act, No. 38 of 1971 and Section 42(2) of the Monetary Law Act, (Chapter 422). In carrying out the audit, I was assisted by a firms of Chartered Accountants in public practice to examine the compliance with International Financial Reporting Standards.

**Management's Responsibility for the Consolidated Financial Statements**

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards and for such internal control as the Management determines is necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error.

**Auditor's Responsibility**

My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with International Standards on Auditing. Those Standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatements.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Bank's preparation and fair presentation of the financial statements 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. Sub-sections (3) and (4) of the Section 13 of the Finance Act, No. 38 of 1971 give discretionary powers to the Auditor General to determine the scope and extent of the Audit.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

**Opinion**

In my opinion, the financial statements give a true and fair view of the financial position of the Central Bank of Sri Lanka as at 31 December 2012, and its financial performance and its cash flows for the year then ended in accordance with International Financial reporting Standards.

H.A.S.Samaraweera  
 Auditor General

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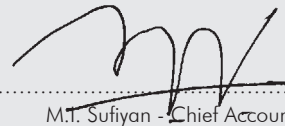
**Central Bank of Sri Lanka**  
**Statement of Financial Position**  
**As at 31 December 2012**

	Note	2012 Rs. 000	2011 Rs. 000
<b>Assets</b>			
<b>Foreign Currency Financial Assets</b>			
Cash & Cash Equivalents		235,278,133	303,551,702
Derivative Financial Instruments	5	3,989,701	2,794,334
Securities at Fair Value through Profit & Loss	6	169,312,604	106,006,361
Available for Sale Investments	6	386,761,690	270,664,801
Other Foreign Receivables		8,243,512	19,361,831
IMF Related Assets	7	81,352,282	73,090,517
<b>Total Foreign Currency Financial Assets</b>		<b>884,937,922</b>	<b>775,469,546</b>
<b>Local Currency Financial Assets</b>			
Sri Lanka Government Securities		175,251,772	183,885,564
Advances to Government	8	111,291,843	94,743,013
Loans to other Institutions	9	1,844,237	2,313,533
Other Local Receivables		2,970,099	2,924,028
Investments in Financial and Other Institutions	10	41,095	41,211
Other Assets	11	5,578,483	4,695,913
<b>Total Local Currency Financial Assets</b>		<b>296,977,529</b>	<b>288,603,262</b>
<b>Total Financial Assets</b>		<b>1,181,915,451</b>	<b>1,064,072,808</b>
<b>Foreign Currency Non-Financial Assets</b>			
Gold		77,688,838	43,819,156
<b>Other Non-Financial Assets</b>			
Inventories	12	2,942,193	2,484,681
Other Receivables and Prepayments		2,296,826	1,980,518
Property, Plant and Equipment	13	13,913,077	9,996,697
Intangible Assets	14	24,153	13,723
Pension and other Post Employment Benefit Plans	41	964,379	991,571
<b>Total Other Assets</b>		<b>97,829,466</b>	<b>59,286,346</b>
<b>Total Assets</b>		<b>1,279,744,917</b>	<b>1,123,359,154</b>
<b>Liabilities and Equity</b>			
<b>Foreign Currency Financial Liabilities</b>			
Amounts Payable to Banks and Financial Institutions	15	2,619,847	937,712
Derivative Financial Instruments	5	3,257,119	1,041,597
Amounts Payable to Asian Clearing Union	16	28,953,955	90,032,085
IMF Related Liabilities	17	467,642,196	328,772,419
Other Foreign Payable	18	64,520,662	58,621,764
<b>Total Foreign Currency Financial Liabilities</b>		<b>566,993,779</b>	<b>479,405,577</b>
<b>Local Currency Financial Liabilities</b>			
Deposits by Banks and Financial Institutions	19	166,288,378	146,269,185
Balances with Government and Governmental Entities	20	699,628	1,799,030
Securities Sold Under Agreement to Repurchase	21	7,015,000	14,089,000
Balances with Employee Benefit Plans	22	1,548,447	904,478
Other Payables	23	31,939,398	28,041,215
<b>Total Local Currency Financial Liabilities</b>		<b>207,490,851</b>	<b>191,102,908</b>
<b>Total Financial Liabilities</b>		<b>774,484,630</b>	<b>670,508,485</b>
<b>Other Liabilities</b>			
Currency in Circulation	24	318,060,142	293,233,361
Deferred Grants	25	2,389	3,468
Miscellaneous Liabilities and Accruals	26	143,916	884,048
<b>Total Other Liabilities</b>		<b>318,206,447</b>	<b>294,120,877</b>
<b>Total Liabilities</b>		<b>1,092,691,077</b>	<b>964,629,362</b>
<b>Equity</b>			
Capital Funds		35,000,000	25,000,000
Reserves		152,053,840	133,729,792
<b>Total Equity</b>		<b>187,053,840</b>	<b>158,729,792</b>
<b>Total Liabilities and Equity</b>		<b>1,279,744,917</b>	<b>1,123,359,154</b>

The Governor and the Chief Accountant of the Central Bank of Sri Lanka authorised these financial statements for issue on 28 February 2013 for and on behalf of the Monetary Board.



Ajith Nivard Cabraal - Governor



M.T. Sufiyan - Chief Accountant

The accounting policies and notes on pages 7 through 47 form an integral part of the Financial Statements.

**Central Bank of Sri Lanka**  
**Income Statement**  
**Year ended 31 December 2012**

	Note	2012 Rs. 000	2011 Rs. 000
<b>Operating Income :</b>			
<b>Income from Foreign Currency Financial Assets</b>			
Interest Income	29	11,505,174	14,435,116
Gain/(Loss) from Unrealized Price Revaluations		296,049	4,884,031
Gain from Realized Price Changes		16,770,494	33,113,886
<b>Total Income from Foreign Currency Financial Assets</b>		<b>28,571,717</b>	<b>52,433,033</b>
<b>Expenses on Foreign Currency Financial Liabilities</b>			
Interest Expense	30	(3,702,966)	(3,910,831)
<b>Total Expenses on Foreign Currency Financial Liabilities</b>		<b>(3,702,966)</b>	<b>(3,910,831)</b>
Net Foreign Exchange Revaluation Gain /(Loss)		25,181,713	3,576,999
<b>Foreign Currency Investment Income</b>		<b>50,050,464</b>	<b>52,099,201</b>
<b>Income from Local Currency Financial Assets</b>			
Interest Income	29	25,957,602	4,768,769
Interest Expense	30	(1,091,540)	(4,541,973)
<b>Total Income from Local Currency Financial Assets</b>		<b>24,866,062</b>	<b>226,796</b>
Other Income	31	976,019	669,399
<b>Total Net Operating Income</b>		<b>75,892,545</b>	<b>52,995,396</b>
<b>Operating Expenses:</b>			
Personnel Expenses:	32		
- Salaries and Wages		(2,865,544)	(2,274,045)
- Defined Contribution Plan Costs		(426,622)	(334,593)
- Additional Contribution to Post Employment Benefit Plan Costs		(344,328)	358,609
		<b>(3,636,494)</b>	<b>(2,250,029)</b>
Depreciation & Amortization		(322,622)	(314,063)
Cost of Inventory		(1,816,933)	(1,707,443)
Administration Expenses	33	(1,378,295)	(1,227,710)
Net Losses on Revaluation of Fixed Assets		(3,963)	-
Sundry Write Offs		-	(64,352)
<b>Total Operating Expenses</b>		<b>(7,158,307)</b>	<b>(5,563,597)</b>
<b>Profit Before Income Tax</b>		<b>68,734,238</b>	<b>47,431,799</b>
Taxation	34	(2,525,694)	(601,593)
<b>Net Profit for the Year</b>		<b>66,208,544</b>	<b>46,830,206</b>

The accounting policies and notes on pages 7 through 47 form an integral part of the Financial Statements.

**Central Bank of Sri Lanka**  
**Statement Of Comprehensive Income**  
**Year ended 31 December 2012**

	2012 Rs. 000	2011 Rs. 000
Net Profit for the Year	66,208,544	46,830,206
<b>Other Comprehensive Income</b>		
Net Fair Value Loss on Available for Sale Securities	1,835,087	11,677,923
Gain on Revaluation of Property, Plant & Equipment	3,280,575	-
Total Comprehensive Income	<u>71,324,206</u>	<u>58,508,129</u>

The accounting policies and notes on pages 7 through 47 form an integral part of the Financial Statements.

**Central Bank of Sri Lanka**  
**Statement Of Changes In Equity**  
**Year ended 31 December 2012**

	Contributed Capital Rs.000	Reserves Appropriated as Capital Rs.000	Revaluation Reserve Rs.000	Other Reserves (Note 27) Rs.000	Retained Earnings Rs.000	Total Rs.000
<b>As at 1 January 2011</b>	15,000	24,985,000	2,706,067	62,320,525	32,195,098	122,221,690
Net Profit	-	-	-	-	46,830,206	46,830,206
Transfer to RTGS Sinking Fund	-	-	-	113,381	(113,381)	-
Transfer to General Reserve	-	-	-	6,573,559	(6,573,559)	-
Transfer to Market Valuation Reserve	-	-	-	(3,484,968)	3,484,968	-
Transfer of Net Foreign Exchange Revaluation Gain	-	-	-	3,576,999	(3,576,999)	-
Transfer to CBSL Specific Reserve	-	-	-	113,561	(113,561)	-
Transfer to Medium & Long Term Reserve	-	-	-	2,000,000	(2,000,000)	-
Other Comprehensive Income	-	-	-	11,677,923	-	11,677,923
Transfer of funds to CBSL Employees & Pension Disaster relief fund	-	-	-	-	(27)	(27)
Transfer of balance Profit to Government- 2010	-	-	-	-	(5,000,000)	(5,000,000)
Transfer of Interim Profits to Government - 2011	-	-	-	-	(17,000,000)	(17,000,000)
<b>As at 1 January 2012</b>	<u>15,000</u>	<u>24,985,000</u>	<u>2,706,067</u>	<u>82,890,980</u>	<u>48,132,745</u>	<u>158,729,792</u>
Net Profit	-	-	-	-	66,208,544	66,208,544
Transfer to RTGS Sinking Fund	-	-	-	153,751	(153,751)	-
Transfer to General Reserve	-	-	-	10,142,076	(10,142,076)	-
Transfer to Market Valuation Reserve	-	-	-	4,884,031	(4,884,031)	-
Transfer of Net Foreign Exchange Revaluation Gain	-	-	-	25,181,686	(25,181,686)	-
Transfer to CBSL Specific Reserve	-	-	-	93,084	(93,084)	-
Transfer to fixed asset revaluation reserve	-	-	3,280,575	-	-	3,280,575
Other Comprehensive Income	-	-	-	1,835,087	-	1,835,087
Transfer of funds to CBSL Employees & Pension Disaster relief fund	-	-	-	-	(158)	(158)
Transfer of balance Profit to Government- 2011	-	-	-	-	(10,000,000)	(10,000,000)
Transfer of Interim Profits to Government - 2012	-	-	-	-	(33,000,000)	(33,000,000)
Transfer to Pension Fund Reserve	-	-	-	1,000,000	(1,000,000)	-
Transfer to Reserve appropriated as capital	-	10,000,000	-	(10,000,000)	-	-
<b>As at 31 December 2012</b>	<u>15,000</u>	<u>34,985,000</u>	<u>5,986,642</u>	<u>116,180,695</u>	<u>29,886,503</u>	<u>187,053,840</u>

The accounting policies and notes on pages 7 through 47 form an integral part of the Financial Statements.

**Central Bank of Sri Lanka**  
**Statement Of Cash Flows**  
**Year ended 31 December 2012**

	Note	2012 Rs. 000	2011 Rs. 000
<b>Cash Flow from Operating Activities</b>			
<b>Receipts:</b>			
Interest Received - Foreign Currency		8,920,505	15,836,021
Interest Received - Local Currency - Others		485,687	473,847
Liquidity Management and Trading Income		16,770,494	33,113,886
Realised Exchange Gain / (Loss)		(2,713,634)	(10,121,791)
Other Income Received		967,667	668,262
		<u>24,430,719</u>	<u>39,970,225</u>
<b>Disbursements:</b>			
Interest Paid - Foreign Currency		3,236,655	3,885,126
Interest Paid - Local Currency		1,095,513	4,404,445
Payments to Employees		3,017,754	2,350,760
Payments to Suppliers		483,137	1,940,048
Income Tax Paid		2,525,694	607,900
		<u>10,358,753</u>	<u>13,188,279</u>
<b>Net Cash Flow from Operating Activities</b>	35	<u>14,071,966</u>	<u>26,781,946</u>
<b>Cash Flows from Investing Activities</b>			
<b>Receipts:</b>			
Net (Increase) /Decrease in Other Local Currency Financial Assets		(1,252,418)	(757,436)
Principal Recoveries from the Loans and Advances to Other Institutions		1,466,198	745,632
Disposal /Redemption of Investments in Financial and Other Institutions		117	24
Sale of Property, Plant and Equipment		74,343	124
Income on Investments in Financial and Other Institutions		-	4,124
Net Increase /(Decrease) in Securities Purchased under Agreement to Re-sell		(7,074,000)	(99,365,891)
		<u>(6,785,760)</u>	<u>(99,373,423)</u>
<b>Disbursements:</b>			
Net Increase /(Decrease) in Foreign Currency Securities		95,692,569	(181,397,956)
Net Increase /(Decrease) in Other Foreign Currency Financial Assets		(266,442)	190,664
Net Increase /(Decrease) in Other Foreign Currency Financial Liabilities		80,569,162	(87,450,517)
Net Increase /(Decrease) in Other Local Deposits and Payables		130	1,312
Purchase of Property, Plant and Equipment net of Grants		957,284	961,494
Net Increase /(Decrease) in Gold Inventory		29,842,972	8,663,832
Loans and Advances granted to other Institutions		996,902	599,318
		<u>207,792,577</u>	<u>(258,431,853)</u>
<b>Net Cash Flow from Investing Activities</b>		<u>(214,578,337)</u>	<u>159,058,430</u>
<b>Cash Flow from Financing Activities</b>			
<b>Receipts :</b>			
Issue of Circulating Currency		(357,381,008)	(335,393,178)
Withdrawal of Circulating Currency		382,207,833	372,974,278
Net Issue of Circulating Currency		24,826,825	37,581,100
<b>Less:</b>			
Net Withdrawals of Circulation Currency on Government Transactions	36	(16,427,265)	177,259,097
Net Withdrawals of Circulation Currency on Transactions with Banks and Financial Institutions	37	(19,325,888)	(41,477,740)
Net Withdrawals of Circulating Currency		(35,753,153)	135,781,357
<b>Net Increase/(Decrease) in Circulating Currency</b>		<u>60,579,978</u>	<u>(98,200,257)</u>
<b>Disbursements:</b>			
Repayment of Foreign Currency Term Liabilities		(97,544,268)	(46,114,023)
Payments to Other Funds		158	27
Transfer of Profits to Consolidated Fund		43,000,000	22,000,000
		<u>(54,544,110)</u>	<u>(24,113,996)</u>
<b>Net Cash Flow from Financing Activities</b>		<u>115,124,088</u>	<u>(74,086,261)</u>
<b>Net Increase/(Decrease) in Cash and Cash Equivalents</b>		<u>(85,382,283)</u>	<u>111,754,115</u>
Exchange Rate Effect on Cash and Cash Equivalents		17,108,714	2,109,928
Cash and Cash Equivalent at the Beginning of the Year		303,551,702	189,687,659
<b>Cash and Cash Equivalent at 31 December</b>	38	<u>235,278,133</u>	<u>303,551,702</u>

The accounting policies and notes on pages 7 through 47 form an integral part of the Financial Statements.



## Central Bank of Sri Lanka

### Notes To The Financial Statements

#### Year ended 31 December 2012

#### 1. Reporting Entity And Statutory Base

The Central Bank of Sri Lanka ("Bank" or "CBSL") is an institution established under the Monetary Law Act No 58 of 1949 of Sri Lanka as amended ("MLA"), as the authority responsible for the administration, supervision and regulation of monetary, financial and payment system of Sri Lanka. Central Bank of Sri Lanka is domiciled in the Democratic Socialist Republic of Sri Lanka and situated at No: 30, Janadhipathi Mawatha, Colombo 01.

These financial statements were authorised for issue by the Governor and Chief Accountant for and on behalf of the Monetary Board on 28 February 2013.

#### 2. Accounting Policies

##### 2.1 Basis of preparation

The financial statements are prepared on the historical cost basis, except for land & buildings and certain financial assets that have been measured at fair value as identified in specific accounting policies below.

##### 2.1.1 Reporting Format

The bank presents financial assets and financial liabilities, and their associated income and expense streams, by distinguishing between foreign currency and local currency activities. In the Statement of Financial Position, assets & liabilities are presented broadly in order of liquidity within such distinguished category. The bank considers that this reporting approach provide appropriate reporting of the bank's activities which are more fully described in Note 4.

##### 2.1.2 Statement of Compliance

These financial statements of the Central Bank of Sri Lanka for the period ended 31 December 2012 have been prepared in accordance with International Financial Reporting Standards (IFRS). The financial statements prepared in accordance with the Monetary Law Act (MLA) are audited by the Auditor General and gazetted as required by the law. Due to certain requirements in the IFRS, the classifications, and hence the amounts in the gazetted financial statements would be different from those in these financial statements.

##### 2.1.3 Currency of Presentation

The Financial Statements are presented in Sri Lankan Rupees (Rs.) and all the values are rounded to nearest Rupees thousands, except when otherwise indicated.

#### 2.2 Significant Accounting Judgments and Estimates

The preparation of the Bank's financial statements requires management to make judgements, estimates and assumptions that affect the reported amount of revenues, expenses, assets and liabilities, and the accompanying disclosures, as well as the disclosure of contingent liabilities. Uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of assets or liabilities affected in future periods.

##### 2.2.1 Impairment of Available for Sale Investments

The bank determines that Available for Sale Investments are impaired when there has been a significant or prolonged decline in the fair value below its cost. This determination of what is significant or prolonged requires judgment.

##### 2.2.2 Pensions and Other Post Employment Benefit Plans

The cost of defined benefit plans is determined using an actuarial valuation. The actuarial valuation involves making assumptions about discount rates, expected rates of return on assets, future compensation increases, mortality rates and future pension increases. Due to the long-term nature of these plans, such estimates are subject to significant uncertainty. Assumptions used are disclosed in Note 41.

#### 2.3 Changes in Accounting Policy and Disclosures

The accounting policies adopted are consistent with those used in the previous financial year.

#### 2.4 Standards, Interpretations and Amendments to Published Standards that are not yet effective

The standards and interpretations that are issued, but not yet effective, up to the date of issuance of the Bank's financial statements are disclosed below. The Bank intends to adopt these standards, if applicable, when they become effective.

##### 2.4.1 IFRS 7 Disclosures - Offsetting Financial Assets and Financial Liabilities - Amendments to IFRS7

These amendments require an entity to disclose information about rights to set-off and related arrangements (e.g., collateral agreements). The disclosures would provide users with information that is useful in evaluating the effect of netting arrangements on an entity's financial position. The new disclosures are required for all recognised financial instruments that are set off in accordance with IAS 32 Financial Instruments: Presentation.

The disclosures also apply to recognised financial instruments that are subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are set off in accordance with IAS 32. These amendments will not impact the Bank's financial position or performance and will become effective for annual periods beginning on or after 1 January 2013.

#### 2.4.2 IFRS 9 Financial Instruments

IFRS 9, as issued, reflects the first phase of the IASB's work though the adoption date is subject to the recently issued Exposure Draft on the replacement of IAS 39 and applies to classification and measurement of financial assets and liabilities as defined in IAS 39. The standard was initially effective for annual periods beginning on or after 1 January 2013, but Amendments to IFRS 9 Mandatory Effective Date of IFRS 9 and Transition Disclosures, issued in December 2011, moved the mandatory effective date to 1 January 2015. In subsequent phases, the Board will address impairment and hedge accounting. The Bank will quantify the effect of the adoption of the first phase of IFRS 9 in conjunction with the other phases, when issued, to present a comprehensive picture.

#### 2.4.3 IFRS 13 – Fair Value measurement

The standard becomes effective for annual periods beginning on or after 1 January 2013. IFRS 13 does not change when an entity is required to use fair value, but rather, provides guidance on how to measure the fair value of financial and non-financial assets and liabilities when required or permitted by IFRS. There are also additional disclosure requirements.

Adoption of the standard is not expected to have a material impact on the financial position or performance of the Bank.

#### 2.4.4 IAS 1 Presentation of Items of Other Comprehensive Income-Amendments to IAS1

The amendments to IAS 1 change the grouping of items presented in other comprehensive income (OCI). Items that could be reclassified (or recycled) to profit or loss at a future point in time (for example, net gains on hedges of net investments, exchange differences on translation of foreign operations, net movements on cash flow hedges and net losses or gains on available-for-sale financial assets) would be presented separately from items that will never be reclassified (for example, actuarial gains and losses on defined benefit plans). The amendment affects presentation only and has no impact on the Bank's financial position or performance. The amendment becomes effective for annual periods beginning on or after 1 July 2012.

#### 2.4.5 IAS 19 Employee Benefits – Amendments

The amendments to IAS 19 remove the option to defer the recognition of actuarial gains and losses, i.e., the corridor mechanism. All changes in the value of defined benefit plans will be recognised in profit or loss and other comprehensive income. The effective date of the standard is 1 January 2013.

The adoption of these amendments will require the Bank to recognise:

- A service cost and a net interest income or expense in profit or loss
- The re-measurements of the pension assets and liabilities, i.e., actuarial gains and losses in the other comprehensive income.

The effect of the first item above will be to replace the expected return on plan assets with a return determined using the discount rate used to discount the defined benefit obligation. At 31 December 2012, the unrecognised losses amount to Rs. 4,797.067 million which will be recorded as an adjustment to other comprehensive income in 2013.

### 3. Summary Of Significant Accounting Policies

#### 3.1 Foreign Currency Conversions

The Bank's functional and presentation currency is Sri Lanka Rupees (Rs). Transactions in foreign currencies are initially recorded in the functional currency prevailing at the date of transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the rate of exchange prevailing at the Statement of Financial Position date. All differences are taken to the Income Statement. For the purposes of retranslation the following Sri Lanka Rupee exchange rates for major currencies were used:

Currency	2012 Rs.	2011 Rs.
1 Australian Dollar	132.2409	115.5813
1 Canadian Dollar	127.8255	111.5750
1 Euro	168.1257	147.4225
1 Japanese Yen	1.4799	1.4669
1 Special Drawing Rights (SDR)	195.311	174.4479
1 Sterling Pound	205.4728	175.4479
1 United States Dollar	127.1608	113.9013
1 Chinese Yuan ( Offshore)	20.4373	17.9457

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using exchange rates at the dates of initial transactions.

### 3.2 Financial Assets and Liabilities

The bank presents financial assets and liabilities, and the associated income and expense streams, by distinguishing between foreign currency and local currency activities. Foreign currency activities mainly arise from the bank's foreign reserves management function. Local currency activities mainly reflect the assets and liabilities associated with monetary policy implementation, issuing currency and banking activities.

The separate reporting of these activities is considered to provide a better presentation of the bank's financial position, financial performance and risk profile. The bank considers that the combined reporting of foreign and local currency activities would weaken the informational value of the financial statements.

All financial assets are initially recognised at cost, being the fair value of the consideration given and including acquisition charges associated with the investment. Subsequent measurement bases after initial recognition are described below. All regular way purchases and sales of financial assets are recognised on the trade date respectively. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place.

#### 3.2.1 Securities at Fair Value through Profit or Loss

Financial assets classified as held for trading are included in the category "securities at fair value through profit or loss". These securities are subsequently valued at quoted market prices. Changes in market values are recognised as an increase or decrease in the value of the securities in the Statement of Financial Position while resulting gains and losses are recognised in the Income Statement.

Where the security is still owned, the gain or loss is reported as "Gain/ (Loss) from Unrealised Price Revaluations". Where the gain or loss has been realised (through selling the security), this is reported as "Gain/ (Loss) from realised Price Revaluations."

#### 3.2.2 Foreign Currency Available-for-Sale Investments

Foreign currency available for sale investments are subsequently valued at quoted market prices. Changes in market value are recognised as an increase or decrease in the value of the available for sale securities in the Statement of Financial Position.

Gains and losses arising from changes in the market value of foreign currency available-for-sale investments are recognised directly in equity (Other Comprehensive Income) which is shown under Other Reserves in the Statement of Financial Position until the investment is sold, collected or otherwise disposed of, or until the investment is determined to be impaired, at which time

the cumulative gain or loss previously reported as equity is included in Income Statement.

#### 3.2.3 Derivative Instruments

The bank uses derivatives such as cross currency swaps and forward foreign exchange contracts for risk management purposes and not for speculative purposes. Derivatives are recorded at fair value and carried as assets when their fair value is positive and as liabilities when their fair value is negative. Changes in the fair value of derivatives are included in 'Gain / (Loss) from Unrealised Price Revaluations'.

#### 3.2.4 International Monetary Fund (IMF) Related Balances

The bank transacts with the International Monetary Fund (IMF) in its own right rather than as the depository of the Government of Sri Lanka. All transactions by the bank with the IMF have been included in these financial statements on that basis.

The bank records the quota with the IMF as an asset and the amount payable to the IMF for quota is recorded as a liability of the bank. The cumulative allocation of SDRs by the IMF is treated as a liability. Exchange gains and losses arising on revaluation of IMF assets and liabilities at the exchange rate applying at Statement of Financial Position date as published by the IMF are recognised in the Income Statement.

All other charges and interest pertaining to balances with the IMF are recorded immediately in the Income Statement.

#### 3.2.5 Cash and Cash Equivalents

Cash and cash equivalents comprise cash at foreign banks and financial institutions and short-term deposits.

As a part of local currency activities CBSL generates certain income and incurs expenses, which do not involve in movement of cash. Those activities result in certain assets and liabilities and mainly comprise of the transactions with the Government of Sri Lanka (GOSL) and transactions with domestic banks and financial institutions. Transactions with GOSL include the purchase of Treasury bills and bonds that are issued by the Government by the bank as a monetary policy mechanism. Such purchases, disposals or interest thereon are reflected as mere book entries in the records of CBSL. These are disclosed separately in Note 35 and Note 36 to these Financial Statements.

As the sole statutory authority, CBSL issues currency to the public in line with Monetary Law Act. Currency issued by CBSL represents a claim on the bank in favor of the holder. This is a liability on the part of the CBSL while it is an item of cash in the hands of the holder. Movement in circulation currency is included as part of financing activities in line with prevailing industry practice among those central banks which present cash flow statements.

CBSL through the cash/pay order process disburses cash in the form of Notes and Coins or cheques drawn on CBSL, to various drawees including suppliers and employees for goods and services obtained, which is either added to the currency in circulation liability or Deposits by Banks and Financial Institutions. Such forms of utilization of currency for the purposes of CBSL's payments form part of cash outflows of CBSL.

For the purposes of the Statement of Cash Flows, cash and cash equivalents consist of cash and cash equivalents as defined above, net of cash/ pay order outflows.

### 3.2.6 Repurchase and Reverse-Repurchase Transactions

Securities sold under agreements to repurchase continue to be recorded as assets in the Statement of Financial Position. The obligation to repurchase (Securities Sold under Agreements to Repurchase) is disclosed as a liability. The difference between the sale and repurchase price in repurchase transactions and the purchase price and sale price in reverse-repurchase transactions represents an expense and income respectively and recognised in the Income Statement.

Securities held under reverse-repurchase agreements are recorded as an asset in the Statement of Financial Position (Securities Purchased under Agreements to Re-sell). Both repurchase and reverse-repurchase transactions are reported at the transaction value inclusive of any accrued income or expense.

### 3.2.7 CBSL Securities

The bank issues CBSL Securities from time to time under its Monetary Policy operations to absorb excess liquidity in the market.

The securities issued are recorded as a liability. The difference between the issue price and the face value is recorded as an expense in the Income Statement.

### 3.2.8 Sri Lanka Government Securities

Sri Lanka Government Securities consists of Treasury bills and bonds purchased from GOSL. The portfolio is recorded in the Statement of Financial Position at amortised cost since they represent loans provided to the GOSL.

### 3.2.9 Advances to Government

Advances to Government represents direct provisional advances made to GOSL under Section 89 of the Monetary Law Act No 58 of 1949 of Sri Lanka, as amended.

### 3.2.10 Loans to Other Institutions

Loans granted to Other Institutions are recognised and carried at the original granted amount less an allowance for any uncollectible amounts. An allowance for doubtful

debts (for loan impairment) is established if there is objective evidence that the bank will not be able to collect all amounts due. The amount of the allowance is the difference between the carrying amount and the estimated recoverable amount. Bad debts are written off when identified.

### 3.2.11 Securities Borrowings and Securities Lending

Bank borrows Government Securities from time to time under its monetary policy operations from major institutional investors. The borrowed securities are used by the bank for repurchase operations to absorb excess liquidity in the market.

The securities borrowings is an unconditional blanket guarantee from the bank for return of securities, payment of agreed fee and on compensation at market rate ( as per the market rates communicated to the primary market participants by the Public Debt Department of the Bank) in events of any failure in delivery.

The market values of the securities borrowed and not used for the repurchase operations at a particular time are recorded as a contingent liability. The commission paid is expensed on accrual basis.

Transfer of securities to counterparties under lending transactions is only reflected on the Statement of Financial Position if the risks and rewards of ownership are also transferred.

### 3.2.12 Impairment of Financial Assets

The bank assesses at each Statement of Financial Position date whether a financial asset is impaired.

### 3.2.13 Assets carried at Amortised Cost

If there is objective evidence that an impairment loss on loans and receivables carried at amortized cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition). The carrying amount of the asset shall be reduced either directly or through use of an allowance account. The amount of the loss shall be recognized in the Income Statement.

The bank first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If it is determined that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, the asset is included in a group of financial assets with similar credit risk characteristics and that group of financial assets is collectively assessed for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or

continues to be recognized are not included in a collective assessment of impairment.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed. Any subsequent reversal of an impairment loss is recognized in the income statement, to the extent that the carrying value of the asset does not exceed its amortized cost at the reversal date.

#### 3.2.14 Available-for-Sale Investments

If an available-for-sale asset is impaired, an amount comprising the difference between its cost (net of any principal payment and amortization) and its current fair value, less any impairment loss previously recognized in profit or loss, is transferred from equity to the income statement. Reversals in respect of equity instruments classified as available-for-sale are not recognized in profit. Reversals of impairment losses on debt instruments are reversed through profit or loss, if the increase in fair value of the instrument can be objectively related to an event occurring after the impairment loss was recognized in profit or loss.

#### 3.2.15 Foreign Currency Term Liabilities

Foreign currency term liabilities are subsequently reported at the amortised cost of the liabilities. Changes in the value of these liabilities are recognised as an increase or decrease in the value of the term liabilities in the Statement of Financial Position. Gains and losses arising from changes in value of foreign currency term liabilities are recognised immediately as expenses in the Income Statement. Where the liability is still owed, the gain or loss is reported as (Gain) /Loss from Unrealised Price Revaluation. Where the gain or loss has been realised (through repayment of the liability), this is reported as (Gains) /Losses Realised from Price Changes.

#### 3.2.16 Financial Guarantees

Financial Guarantees are initially recognised in the financial statements at fair value. Subsequent to initial recognition, the bank's liability under each guarantee is measured at the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee.

#### 3.2.17 Other Financial Assets and Liabilities

Local and foreign currency cash, deposits and short-term advances are recognised on trade date.

### 3.3 Other Assets and Liabilities

#### 3.3.1 Gold

Section 67 (1) of the Monetary Law Act which specifies the composition of the International Reserve indicates that

gold may be held by the CBSL as part of this Reserve. Hence, CBSL holds Rs. 85.9 Bn in gold as part of its International Reserves as at 31 December 2012. As this gold is part of the International Reserve and not used as a commodity which is traded during the normal course of business, gold is fair valued and the gains or losses are transferred to the income statement. Prior to appropriation of profits, the unrealised gains or losses from gold are transferred to the relevant reserve account.

#### 3.3.2 Staff Loans

Bank employees are entitled to loan facilities under concessionary interest rates. These loans are fair valued as per IAS 39 using discounted cash flows.

**Discount rate** - The rate compiled by the Economic Research Department of CBSL (ERD) based on the long term inflation target on USD – Commercial Interest Reference Rate (CIRR) plus 1 per cent added for the risk premium as agreed by the Audit Committee of the Bank is used as the discount rate and it varies with the period of the loans.

The difference between the present value of the staff loan as at the end of a year and beginning of the year have been amortized yearly to record the expense incurred by the bank in providing these loans at concessionary rates and equivalent amount is recorded as other income to record the income that would have been earned by the bank if these loans were granted at market rates.

#### Assumptions used for computation of fair valuation

- The staff loans granted from 2008 are considered.
- The date of staff loan granted is considered as January.
- There were no amendments or early settlements.

Central Bank with a view to simplify the loan management system, consolidated and reschedules computer loans and two loans under Category B into a single loan per borrower, with a total loan limit of Rs. 300,000.00 and for a repayment period of ten years. Further, under this category outstanding loan balance together with the new loan will be rescheduled whenever a new loan is granted.

#### 3.3.3 Inventories

Inventories are carried at lower of cost and net realisable value. Cost is determined on a weighted average basis. Allowance is made for slow moving inventories.

#### 3.3.4 Property, Plant and Equipment

Property, Plant and Equipment is stated at cost, excluding the costs of day-to-day servicing, less accumulated depreciation and accumulated impairment in value. Such

cost includes the cost of replacing part of such Property, Plant and Equipment when that cost is incurred if the recognition criteria are met. Land and buildings are measured at fair value less depreciation on Buildings and impairment charged subsequent to the date of the revaluation.

Except for the freehold land, depreciation is calculated on a straight-line method over the following estimated useful lives.

<b>Class of Asset</b>	<b>Useful Life</b>
Buildings on Freehold Lands	Over 50 Years
Buildings on Lease Hold lands	Over the Lease Period
Plant & Plant Integrals	20 Years
Furniture & Equipments	10 Years
Motor Vehicles	5 Years
Computer Hardware	4 Years
Others	3 Years

The carrying values of plant and equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable. Initial recognition at cost, land and buildings are carried at a revalued amount, which is the fair value at the date of the revaluation less any subsequent accumulated depreciation on buildings and subsequent accumulated impairment losses.

Policy for revaluation of Land & Building of the bank is at least once in five years or at any shorter interval when a significant valuation adjustment becomes evident.

Any revaluation surplus is credited to the Revaluation Reserve included in the equity section of the Statement of Financial Position, except to the extent that it reverses a revaluation decrease of the same asset previously recognized in Income Statement, in which case the increase is recognized in Income Statement. A revaluation deficit is recognized in Income Statement, except that a deficit directly offsetting a previous surplus on the same asset is directly offset against the surplus in the Revaluation Reserve. Upon disposal, any revaluation surplus relating to the particular asset being sold is transferred to retained earnings. An item of Property, Plant and Equipment is de-recognized upon disposal or when no future economic benefits are expected from its use or disposal.

Any gain or loss arising on de-recognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the Income Statement in the year the asset is de-recognized. The asset's residual values, useful life and methods are reviewed, and adjusted if appropriate, regularly.

### 3.3.5 Intangible Assets

Computer software not integral to computer hardware are shown as intangible assets and recognized at cost. Following initial recognition these intangible assets are carried at cost less any accumulated amortization based on a useful life of 4 years.

### 3.3.6 Receivables

Receivables are carried at expected realizable value after making due allowance for doubtful debts, based on objective evidence.

### 3.3.7 Sundry Assets

Other sundry assets are carried at expected realisable values.

### 3.3.8 Impairment of Non-Financial Assets

The bank assesses at each end of reporting period if events or changes in circumstances indicate that the carrying value may be impaired, whether there is an indication that a non-financial asset may be impaired. If any such indication exists, the bank makes an estimate of the asset's recoverable amount. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount.

### 3.3.9 Provisions

Provisions are recognised when the bank has a present obligation (legal or constructive) as a result of a past event and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where the bank expects a provision to be reimbursed, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain.

### 3.3.10 Currency in Circulation

Currency issued by the CBSL represents a claim on the bank in favour of the holder. The liability for Currency in Circulation is recorded at face value in the Statement of Financial Position.

### 3.3.11 Pension and Other Post Employee Benefit Plans

Pension and other Post Employment Benefit Plans operated by the bank are disclosed in Note 41.

### 3.3.12 Defined Benefit Plans

The bank operates defined benefit schemes for Pension, Widows' and Orphans' Pensions (W&OP), Widowers' and Orphans' Pensions (WR&OP), Retirement Gratuity and Post Employment Medical Benefits. The bank and

eligible beneficiaries make contributions, to separately administered funds in respect of the first three schemes. The cost of providing benefits under the defined benefit plans is determined separately for each plan using the projected unit credit actuarial valuation method. Actuarial valuations are carried out once in every three years

The Past service cost is recognised as an expense on a straight-line basis over the average period until the benefits become vested. If the benefits are already vested immediately following the introduction of, or changes to, a benefit plan, past service cost is recognised immediately.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions in excess of the greater of 10% of the value of plan assets or 10% of the defined benefit obligation are charged or credited to income over the employees' expected average remaining working lives, in a systematic method that results in faster recognition of actuarial gains and losses.

### 3.3.13 Defined Contribution Plans

Employees are eligible for Employees' Provident Fund Contributions and Employees' Trust Fund Contributions in line with respective statutes and regulations. The bank contributes 24% and 3% of employees' gross emoluments to Employees' Provident Fund and Employees' Trust Fund respectively which are separately administered defined contribution plans.

### 3.3.14 Grants

Grants recognised at their fair value (where there is a reasonable assurance that the grant will be received and all attaching conditions, if any, will be complied with) are shown under equity. When the grant relates to an expense item it is recognised in the Income Statement over the periods necessary to match them to the expenses it is intended to compensate on a systematic basis. Where the grant relates to an asset, the fair value is credited to a deferred government grant account and is released to the Income Statement over the expected useful life of the relevant asset on a systematic basis consistent with the depreciation policy of the related asset.

### 3.3.15 Personnel Expenses

Personnel Expenses include the full cost of all staff benefits. Salaries and related expenses due at year-end are included in other local payables.

### 3.3.16 Operating Leases

Where the bank is the lessee, the lease rentals payable on operating leases are recognised in the Income Statement over the term of the lease on a basis consistent with the expected benefits derived from the leased assets.

### 3.3.17 Taxation

The income of the bank is exempt from tax under section 118 of the Monetary Law Act 58 of 1949 as amended.

### 3.3.18 Revenue & Expenses

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the bank and the revenue can be reliably measured. Expenses are recognised in the income statement on the basis of a direct association between the cost incurred and the earning of specific items of income. All expenditure incurred in the running of the business and in maintaining the property, plant & equipment in a state of efficiency has been charged to income in arriving at the result for the year.

The following specific recognition criteria must also be met before revenue and expenses are recognised:

#### 3.3.19 Interest

Interest income and expense are recognised in the income statement for all interest bearing instruments on an accrual basis using the effective yield method based on the actual purchase price unless collectability is in doubt. Interest income includes coupons earned on fixed income investments and securities and accrued discount and premium on treasury bills and other discounted instruments. Interest income is suspended when loans become doubtful of collection. Such income is excluded from interest income until received.

#### 3.3.20 Dividends

Dividend income is recognised when the shareholder's right to receive the payment is established.

#### 3.3.21 Miscellaneous

Miscellaneous income and expenses are recognised on an accrual basis.

Net gains and losses of a revenue nature on the disposal of Property, Plant & Equipment have been accounted for in the Income Statement, having deducted from proceeds on disposal, the carrying amount of the assets and related selling expenses.

Gains and losses arising from incidental activities to the main revenue generating activities and those arising from a group of similar transactions which are not material, are aggregated, reported and presented on a net basis.

#### 3.3.22 Contingent Liabilities and Commitments including Off Statement of Financial Position Items

All guarantees of indebtedness, forward foreign exchange transactions and other commitments, which represent Off Statement of Financial Position items are shown under respective headings recognised as Off Statement of Financial Position items. Where applicable, such amounts are measured at best estimates.

#### 4. Nature And Extent Of Activities

The Monetary Board of the CBSL is, in addition to determining the policies or measures authorized to be adopted or taken under Monetary Law Act No 58 of 1949 of Sri Lanka as amended, vested with the powers, duties and functions of the CBSL and be generally responsible for the management, operations and administration of the bank. The bank is primarily responsible for the administration supervision, regulation of monetary, financial, and payment system of Sri Lanka and also acts as the fiscal agent of the Government. The activities of the bank mainly include:

- Implementing monetary and exchange rate policies.
- Issuing of currency.
- Facilitating free competition and stability in the financial system.
- Licensing and supervision of defined financial institutions.
- Organization and management of the inter-bank settlement system and promotion of the smooth functioning of the payments system.
- Providing loans and advances to the Government, bank and financial institutions under various facilities.
- Acting as a depository of the Government under specific arrangements with Government and agencies acting on behalf of the Government.

The activities carried out in order to achieve its objective of economic, price and financial system stability with a view to encouraging and promoting the development of the productive resources of Sri Lanka can be broadly segregated into foreign currency and local currency activities. Results of these activities are taken to mean Operating Activities in the context of the Income Statement.

##### 4.1 Foreign Currency Activities

Foreign currency activities result mainly from the CBSL's holdings of foreign currency assets under its foreign reserves management function. The foreign reserves management portfolio comprises foreign currency assets held for foreign exchange intervention purposes and other foreign currency assets held for trading purposes.

The foreign currency assets are held in various currencies. The majorities are denominated in United States Dollars, Australian Dollars, Euros, Sterling Pounds and Japanese Yen and New Zealand Dollar. The financial instruments held within these foreign currency portfolios consist mainly of sovereign securities, securities held under reverse-repurchase transactions or balances held with other central banks, commercial banks and custodial institutions.

The CBSL also holds, from time-to-time, foreign currency assets and liabilities that arise from international market operations.

#### 4.2 Local Currency Activities

Local currency activities arise as follows:

- Liquidity management operations. Liquidity management largely involves the CBSL offsetting the daily net flows to or from government or market by advancing funds to or withdrawing funds from the banking system. Most of this business is undertaken through daily open market operations.
- Holding an investment portfolio comprising Sri Lanka government securities to support the liability for currency in circulation. The bank's policy is to hold these investments for monetary operations and not for trading.

#### 4.3 Trust and Custodial Activities

Amounts administered by the CBSL under custodial and administration arrangements are not included in these financial statements, as they do not form part of elements of financial statements of the bank.

#### 5. Derivative Financial Instruments

The table below shows the fair values of derivative financial instruments, recorded as assets or liabilities, together with their notional amounts. The notional amount, recorded gross, is the amount of derivative's underlying asset, reference rate or index and is the basis upon which changes in the value of derivatives are measured. The notional amounts indicate the volume of transactions outstanding at the year end and are indicative of neither the market risk nor the credit risk.

	Assets	Liabilities	Notional Amount	Assets	Liabilities	Notional Amount
	2012	2012	2012	2011	2011	2011
	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000
Currency SWAPS	3,989,701	3,250,937	205,552,318	2,794,334	1,041,597	310,813,574
Forward Forex	-	6,182	1,027,364	-	-	-
	<u>3,989,701</u>	<u>3,257,119</u>	<u>206,579,682</u>	<u>2,794,334</u>	<u>1,041,597</u>	<u>310,813,574</u>

Derivatives often involve at their inception only a mutual exchange of promises with little or no transfer of consideration. However, these instruments frequently involve a high degree of leverage and are very volatile.

A relatively small movement in the value of the asset, rate or index underlying a derivative contract may have a significant impact on the profit or loss of the bank.

Over-the-counter derivatives may expose the bank to the risks associated with the absence of an exchange market on which to close out an open position.

The bank's exposure under derivative contracts is closely monitored as part of the overall management of the bank's market risk.



The bank uses derivatives such as cross currency swaps and forward foreign exchange contracts for risk management purposes and not for speculative purposes. Derivatives are recorded at fair value and carried as assets when their fair value is positive and as liabilities when their fair value is negative.

### Swaps

Swaps are contractual agreements between two parties to exchange streams of payments over time based on specified notional amounts, in relation to movements in a specified underlying index such as an interest rate, foreign currency rate or equity index.

## 6. Financial Assets

	2012 Rs. 000	2011 Rs. 000
Securities at Fair Value through Profit & Loss	169,312,604	106,006,361
Available for Sale Investments	<u>386,761,690</u>	<u>270,664,801</u>
<b>Total Financial Assets</b>	<b><u>556,074,294</u></b>	<b><u>376,671,162</u></b>

## 7. IMF Related Assets

	2012 Rs. 000	2011 Rs. 000
Holding in Special Drawing Rights	491,322	502,112
IMF Quota	80,741,567	72,290,845
Deposits with IMF	119,393	137,934
Pre Paid Commitment Fee	-	159,626
<b>Total IMF Related Assets</b>	<b><u>81,352,282</u></b>	<b><u>73,090,517</u></b>

### Holding of Special Drawing Rights (SDR)

Holding of Special Drawing Rights (SDR) is potentially a claim on the freely usable currencies of IMF members, in that holders of SDRs can exchange their SDRs for their currencies. The SDRs value as a reserve asset derives from the commitments of members to hold and accept SDRs, and to honour various obligations connected with the operation of the SDR system. The IMF ensures that the SDRs claim on freely usable currencies is being honoured in two ways: by designating IMF members with a strong external position to purchase SDRs from members with weak external positions, and through the arrangement of voluntary exchanges between participating members in a managed market. The amount shown above represents the total holding of the Bank as at the respective Statement of Financial Position dates.

### IMF Quota

The International Monetary Fund (IMF) is an international organization of 187 member countries. It was established to promote international monetary cooperation, exchange

stability, and orderly exchange arrangements; to foster economic growth and high levels of employment; and to provide temporary financial assistance to countries to help ease balance of payments adjustment. Quotas (capital subscriptions) are the primary source of IMF resources. The IMF receives its resources from its member countries. Each country's subscription or quota is determined broadly on the basis of the economic size of the country, and taking into account quotas of similar countries. Upon joining the IMF, a country must pay 25 percent of its quota in widely accepted foreign currencies or SDRs, and the remaining 75 percent in its own currency.

**Subscriptions:** A member's subscription to IMF resources is equal to its quota and determines the maximum amount of financial resources the member is obliged to provide to the IMF. A member must pay its subscription in full: up to 25 percent must be paid in reserve assets specified by the IMF (SDRs or usable currencies), and the rest in the member's own currency.

**Voting power:** The quota defines a member's voting power in IMF decisions. Each IMF member has 250 basic votes plus one additional vote for each SDR 100,000 of quota.

**Access to financing:** The amount of financing, a member can obtain from the IMF (Access limits) is based on its quota. Under Stand-By and Extended Arrangements, for instance, a member can currently borrow up to 200 percent of its quota annually and 600 percent cumulatively. Access may be higher in exceptional circumstances and to meet specific problems.

**SDR allocations:** Members' shares of SDR allocations are established in proportion to their quotas.

IMF quota therefore represents an asset, and the Bank transacting with the IMF in its own right rather than as an agent for the GOSL, reflects IMF Quota as an asset in its financial statements. The amounts payable in respect of the IMF Quota is shown under the heading Quota Liability in Note 17.

### PRGF – HIPC Trust Deposit

The PRGF – HIPC (Poverty Reduction Growth Facility for the Heavily Indebted Poor Countries) Trust Deposit was made under the agreement between the GOSL and the IMF on 21 April 2000 by transferring SDR 788,783 from Sri Lanka's deposit in the post SCA-2 (Special Contingent Account) administered account with the IMF. This account was created under the guidance of the IMF by transferring the balance held in SCA-2 against Sri Lanka when it was decided to wind up SCA-2 by the IMF. IMF requested the countries that had balances in the Post SCA-2 account to consider providing the balances in that account to the PRGF/HIPC trust either as outright grant or as a means of providing a subsidy for PRGF/HIPC Loan. Accordingly GOSL agreed to transfer the funds from Post SCA –2 accounts to PRGF/HIPC trust account, not as an outright grant, but as an interest free deposit until 2018.

**8. Advances To Government**

	2012 Rs. 000	2011 Rs. 000
Revolving Credit	111,291,843	94,743,013
	<u>111,291,843</u>	<u>94,743,013</u>

As per Section 89 of the Monetary Law Act No: 58 of 1949 of Sri Lanka, as amended, the Central Bank may make direct provisional advances to the Government of Sri Lanka (GOSL) to finance expenditure authorised to be incurred out of the Consolidated Fund, provided that every such advance shall be repayable within a period not exceeding six months, and the total outstanding at anytime shall not exceed ten percent of the estimated revenue of the GOSL for the financial year in which they are made. The above balance represents such advances made by the Bank.

**9. Loans To Other Institutions**

	2012 Rs. 000	2011 Rs. 000
Receivable under Medium & Long Term Credit Scheme (MLTC)		
- Related Parties	39,510	41,644
- Others	607	668
Receivable under Susahana Tsunami Loan Scheme Phase I & II:		
- Related Parties	191,982	314,388
- Others	63,301	129,472
Receivable under Provincial Development Credit Loan Scheme - Related Parties	1,576,139	1,854,663
<b>Less:</b>		
Allowance for Doubtful Receivables	(27,302)	(27,302)
<b>Net Receivable</b>	<u>1,844,237</u>	<u>2,313,533</u>

Movement in Allowance for Doubtful Receivables is as follows:

	2012 Rs. 000	2011 Rs. 000
At the beginning of the year	27,302	1,963,796
Write Off of Doubtful Debts	-	(1,936,494)
<b>At the end of 31 December</b>	<u>27,302</u>	<u>27,302</u>

**10. Investments In Financial And Other Institutions**

- (i) The Monetary Law Act No. 58 of 1949 of Sri Lanka, as amended, specifically prohibits the Bank from engaging in trade or otherwise having a direct interest in any commercial, industrial or other undertaking or to purchase shares of other banking institutions in the normal course of business. However, the Act authorises the Bank to acquire and hold shares in any company, which in the opinion of the Monetary Board was formed for the advancement and promotion of human resources and technological development in the banking and financial sector or to facilitate clearance of transactions among commercial banks operating in Sri Lanka.

- (ii) Based on the above requirements, the Bank holds the following investments as at the Statement of Financial Position date.

Investee	Business	% Holding	
		2012	2011
Lanka Clear (Private) Limited	Automated Clearing	19.66	19.66
Fitch Ratings Lanka Limited	Credit Rating	10	10
Lanka Financial Services Bureau Limited	Automated Fund Transfers	7.5	7.5
Credit Information Bureau of Sri Lanka Limited	Provision of Credit Information	19.3	19.68

- (iii) The carrying value of investments in the respective entities are as follows:

	2012 Rs. 000	2011 Rs. 000
Credit Information Bureau of Sri Lanka Limited	5,845	5,961
Lanka Clear (Private) Limited	29,500	29,500
Fitch Ratings Lanka Limited	3,500	3,500
Lanka Financial Services Bureau Limited	2,250	2,250
<b>Total Investments in Financial and Other Institutions</b>	<u>41,095</u>	<u>41,211</u>

**11. Other Assets**

	2012 Rs. 000	2011 Rs. 000
Investment of Funds	1,799,394	1,493,045
Staff Loans at Amortized Cost	3,771,816	3,202,868
Investment in Debentures at Amortized Cost	7,273	-
	<u>5,578,483</u>	<u>4,695,913</u>

Investment in Debentures represents debentures received by the bank in part settlement of refinance loans obtained by Mercantile Credit Limited (MCL) which was written off in 2011.

A total value of Rs. 10,839,500 debentures of Sri Lanka Savings Bank received by the bank and it is stated at the amortized cost. The debentures are 10 years unsecured, subordinated and redeemable and carry an interest at 5% per annum or one year Treasury Bill yield rate whichever is less to be accrued annually.

**12. Inventories**

	2012 Rs. 000	2011 Rs. 000
Notes for Circulation	2,171,534	1,895,335
Coins for Circulation	706,071	427,137
Notes in Transit	51,564	51,564
Coins in Transit	-	98,963
	<u>2,929,169</u>	<u>2,472,999</u>
Less: Allowance for Slow Moving Items	(25,000)	(25,000)
	<u>2,904,169</u>	<u>2,447,999</u>
Stationery and Sundry Inventory	37,908	36,682
Medical Center	116	-
<b>Total Inventories at Lower of Cost and Net Realizable Value</b>	<u>2,942,193</u>	<u>2,484,681</u>

<b>13. Property, Plant And Equipment</b>										
	Land and Buildings	Plant & Plant Integrals	Furniture & Equipment	Vehicles	Computers	Others	Reading Materials	Construction In progress	2012 Total	2011 Total
	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000
<b>Cost</b>										
As at 01 January	8,749,381	1,100,507	731,822	320,771	713,137	47,473	751,744	12,414,835	11,460,279	
Revaluation	2,746,379	-	-	-	-	-	-	2,746,379	-	
Additions	841,319	43,754	48,780	98,199	30,721	1,574	645,203	1,709,550	1,247,490	
Disposals / Transfers	(5,000)	-	(15,837)	(18,251)	(23,484)	-	(763,041)	(825,613)	(292,934)	
<b>As at 31 December</b>	<b>12,332,079</b>	<b>1,144,261</b>	<b>764,765</b>	<b>400,719</b>	<b>720,374</b>	<b>49,047</b>	<b>633,906</b>	<b>16,045,151</b>	<b>12,414,835</b>	
<b>Depreciation</b>										
	Land and Buildings	Plant & Plant Integrals	Furniture & Equipment	Vehicles	Computers	Others	Reading Materials	Construction In progress	2012 Total	2011 Total
	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000
As at 01 January	509,175	480,305	524,560	234,938	640,699	28,461	-	2,418,138	2,115,939	
Revaluation	(541,949)	-	-	-	-	-	-	(541,949)	-	
Depreciation for the year	158,210	56,957	33,795	31,999	29,900	1,209	-	312,070	303,380	
Disposals	-	-	(14,805)	(18,251)	(23,129)	-	-	(56,185)	(1,181)	
<b>As at 31 December</b>	<b>125,436</b>	<b>537,262</b>	<b>543,550</b>	<b>248,686</b>	<b>647,470</b>	<b>29,670</b>	<b>-</b>	<b>2,132,074</b>	<b>2,418,138</b>	
<b>Net Book Value</b>	<b>12,206,643</b>	<b>606,999</b>	<b>221,215</b>	<b>152,033</b>	<b>72,904</b>	<b>19,377</b>	<b>633,906</b>	<b>13,913,077</b>	<b>9,996,697</b>	
The book values of land and buildings are recorded at fair value. The latest independent valuation was performed as at 31 March 2012 by P. B. Kalugalagedara (Chartered Valuer), which was recorded as at 30 April 2012.										
Composition of Land and Buildings is as follows:										
	Carrying Value 2012	Carrying Value 2011								
	Rs. 000	Rs. 000								
Freehold Land	5,180,100	2,943,278								
Buildings on Freehold Land	6,939,096	5,229,793								
Buildings on Leasehold Land	87,447	67,135								
	<b>12,206,643</b>	<b>8,240,206</b>								
The carrying amount of revalued land & building that would have been included in the financial statements had they been carried at cost less depreciation is Rs. 9,464.544 Mn (2011 Rs. 6,609.783 Mn).										
<b>14. Intangible Assets</b>										
		2012	2011							
		Rs. 000	Rs. 000							
<b>Computer Software:</b>										
<b>Cost:</b>										
As at 1 January		595,731	590,097							
Additions		19,266	5,634							
As at 31 December		<b>614,997</b>	<b>595,731</b>							
<b>Amortization and Impairment:</b>										
As at 1 January		582,008	572,344							
Amortization Charge for the year		8,836	9,664							
As at 31 December		<b>590,844</b>	<b>582,008</b>							
<b>Net Book Value:</b>										
As at 1 January		13,723	17,753							
As at 31 December		<b>24,153</b>	<b>13,723</b>							
<b>15. Amounts Payable To Banks And Financial Institutions</b>										
		2012	2011							
		Rs. 000	Rs. 000							
Payable to Foreign Banks		1,485,466	387,250							
Payable to other Foreign Financial Institutions		1,134,381	550,462							
		<b>2,619,847</b>	<b>937,712</b>							
<b>16. Amount Payable To The Asian Clearing Union</b>										
		2012	2011							
		Rs. 000	Rs. 000							
Payable as at the end of the year		28,953,955	90,032,085							
		<b>28,953,955</b>	<b>90,032,085</b>							
The Asian Clearing Union (ACU) was established in 1974 under the auspices of the Economic and Social Commission										

for Asia and the Pacific as a mechanism for settlement of payments among participating countries' Central Banks. Sri Lanka is one of the participants. The other participants are Bangladesh, the Islamic Republic of Iran, Nepal, Pakistan, India, Bhutan and Myanmar. This is a clearing facility to settle, on a multilateral basis, payments for current international transactions among territories of participants. Net position as at end of each month is settled or received, after two-month credit period. Interest between 0.01 % and 0.17 % in USD (2011 - 0.00% and 0.20%) & Interest between 0.00 % and 0.01 % in EUR (2011 - 0.06% and 1.11 %) is paid by net debtors to the facility and transferred to net creditors on daily balances outstanding between settlement dates. Above balance represents the amounts due to ACU at the respective Statement of Financial Position dates.

### 17. IMF Related Liabilities

	2012 Rs. 000	2011 Rs. 000
Interest Bearing Loans -		
Non Current	260,727,978	189,229,942
Interest Bearing Loans - Current	58,278,166	6,463,246
Allocation of Special Drawing Rights	77,237,728	69,153,731
Other Amounts Payable to IMF	48,432,045	40,510,385
Quota Liability	22,966,279	23,415,115
	<u>206,914,218</u>	<u>139,542,477</u>
<b>Total IMF Related Liabilities</b>	<b><u>467,642,196</u></b>	<b><u>328,772,419</u></b>

Interest bearing Loans consist of Poverty Reduction & Growth Facility (PRGF), Extended Fund Facility (EFF) ) as well as Stand By Arrangement (SBA) with the IMF.

#### Poverty Reduction & Growth Facility (PRGF)

PRGF is a long term financing facility given by IMF to its lower income-earning members. This arrangement was previously known as Enhanced Structural Adjustment Facility (ESAF). The main aim of this program is to reduce poverty and to promote high growth on a sustainable basis leading to higher living standards. The interest rate levied on PRGF loans is 0.5 percent per annum. The repayment period given for such loans by IMF is over a maximum period of 10 years.

#### Extended Fund Facility (EFF)

EFF is an IMF financing facility that supports medium term programs that seek to overcome Balance of Payment difficulties stemming from macroeconomic imbalances & structural problems. This is an extended facility of ESAF. The interest rate levied on EFF loan is 0.5 percent per annum. The repayment period given for this loan by IMF is over a period of 10 years with a grace period of 4 ½ years.

#### Stand By Arrangement (SBA)

The executive board of the IMF approved a 20-month stand by arrangement in an amount equivalent to SDR 1.65 Bn (USD 2.6 Bn) on 24 July 2009 to Sri Lanka as a balance

of payment (BOP) support. On 28 July 2009 and on 10 November 2009 two tranches of the loan equivalent to SDR 413.4 Mn (USD 651.36 Mn) were received by Sri Lanka. On 30 June 2010, Sri Lanka received the third and fourth tranches together, amounting to SDR 275.6 Mn ( USD 407.78 Mn). On 28 September 2010, 07 February 2011 and 06 April 2011, the fifth, sixth and seventh tranches of the loan each equivalent to SDR 137.8 Mn ( USD 212.46 Mn, USD 216.61 Mn and USD 218.48 Mn respectively) were received by Sri Lanka. On 04 April 2012 the eighth tranche of the loan equivalent of SDR 275.6 Mn (USD 233.64 Mn & EUR 144.98 Mn ) were received while the final tranche of the loan equivalent to SDR 275.6 Mn (USD 337.53 & EUR 63.31Mn ) was received on 24th of July 2012.

The loan is repayable within 4 years commencing October 2012. The first repayment was made on 25 October 2012, equivalent of SDR 25.8 Mn ( EUR 30.6 Mn). The rate of interest of the SBA facility is composed of two components; the service charge and a fixed margin. The service charge is calculated weekly, based on the SDRs rate. The fixed margin is 1 per cent per annum for the outstanding loan amount up to 300 percent of the quota. When the outstanding loan amount exceeds 300 percent of the quota, a surcharge of 2 percent per annum will be levied on the outstanding in excess of 300 percent.

#### The key objectives of the SBA are as follows,

- To support the country's economic reform program.
- To strengthen the country's fiscal position while ensuring the availability of resources for much needed post-conflict reconstruction & relief efforts.
- Intent to rebuild international reserves and strengthen Sri Lanka's domestic financial system.  
To lay a strong macroeconomics foundation that will help the authorities approach the boarder international community for financial support in post conflict reconstruction.
- Reducing the central government budget deficit.
- To strengthen the banking system by improving the current regulatory framework and enhancing bank supervision.

The amounts expected to be settled before and after 12 months in connection with Interest Bearing Loans are as follows:

	Effective interest rate %	Maturity	2012 Rs. 000	2011 Rs. 000
<b>Current</b>				
EFF			336,423	602,424
PRGF 2	0.50		749,799	1,342,644
SBA			57,191,944	4,518,178
			<u>58,278,166</u>	<u>6,463,246</u>
<b>Non-current</b>				
SBA		2017	260,727,978	188,257,408
PRGF 2	0.50	2013	-	671,322
EFF	1.08	2013	-	301,212
			<u>260,727,978</u>	<u>189,229,942</u>
<b>Total Interest bearing Loans</b>			<b><u>319,006,144</u></b>	<b><u>195,693,188</u></b>

### Allocation of Special Drawing Rights (SDR)

The SDR is a reserve asset created by the IMF in order to meet a long-term global need to supplement existing reserve assets. SDRs are allocated to member countries in proportion to their IMF quotas. SDR allocations can only be made to countries that participate in the IMF's SDR Department (an accounting unit within the IMF). The IMF to supplement existing official reserve assets, such as gold holdings, foreign exchange, and reserve positions in the IMF, created SDRs. Under certain conditions, which are set in the Articles of Agreement signed on behalf of the Government of Sri Lanka by the Bank, the IMF may allocate SDRs to members in proportion to their IMF quotas. An allocation of SDRs by the IMF provides each member with a costless asset on which interest is neither earned nor paid. The Articles of Agreement also allow for cancellations of SDRs, but to date, this provision has not been used. Increases in Allocation of SDR represents increases in Holding of SDR as described in Note 7. Members of IMF shall be obligated to pay to the IMF an amount equal to its net cumulative allocation and any other amounts that may be due and payable because of its participation in the Special Drawing Rights Department at the point of termination or liquidation of IMF's SDR Department.

### Other Amounts Payable to IMF

These represent amounts owed by the Bank to IMF on account of operational and administrative transactions.

### Quota Liability

The amounts payable in respect of the IMF Quota as described in Note 7 is shown under the heading Quota Liability.

### 18. Other Foreign Payables

	2012 Rs. 000	2011 Rs. 000
China Development Bank (CDB) Loan	-	2,847,532
Amount due to CDB under Escrow Agreement	43,324,799	53,359,431
EIB/DFCC Global Loan II	35,268	-
Ministry of Finance (Moragahakanda)	19,056,691	-
Other Foreign Liabilities	<u>2,103,904</u>	<u>2,414,801</u>
	<u>64,520,662</u>	<u>58,621,764</u>

### Amount due to CDB under Escrow Agreement

A Facility Agreement between China Development Bank Corporation (CDB) and Government of Sri Lanka was signed on 31 March 2011 for USD 500 Million. According to the Facility Agreement, as Escrow Agent, an Escrow Account has been opened in the Central Bank of Sri Lanka for the sole purpose of deposit of the Loans, which account shall be jointly operated by the lender and the borrower pursuant to this Agreement.

The first tranche of Escrow Funds USD 326 Mn received on 29 June 2011 and second tranche of USD 174 Mn received on 28 October 2011.

The lender instructs the Escrow Agent to disburse the Escrowed Funds in to the account specified in the Disbursement Request by sending a Notice of Approval to the Escrow Account.

After receiving a Notice of Approval from the CDB, first disbursement has been made on 18 October 2011 amounting to USD 1.768 Mn.

### EIB / DFCC Global Loan 2

As per the EURO 50 million loan agreement loans has been received in EURO for the purpose of micro financing from the European Investment Bank. However, later part of the loan has been received in US Dollar. As per the request made by the Treasury Operations Department, CBSL has to open a Special Dollar account in Central Bank general ledger account no 4897 to channel funds to DFCC Bank under EIB/DFCC Global Loan 2. On 3rd Feb 2012, USD 12.7 million received from European Investment Bank. As the second installment of US \$ 19.2 million has been received on 01 June 2012. First disbursement has been made on 1 March 2012, US \$ 4,002,299.29. Another two disbursements of US \$ 6,573,500 & 2,142,170.71 were made on 3 May 2012. On 14 August 2012, US \$ 12,342,500 & 6,171,250 amounts of disbursements were made by CBSL according to the request made by TOD. The remaining balance is US \$ 750,720

### Moragahakanda Development Project

This Loan Agreement was signed between China Development Bank (as lender) and Ministry of Finance and Planning (as borrower) and Central Bank of Sri Lanka (as bank). Purpose of this loan agreement is to provide facility for financing the construction of a hydroelectric power station at Moragahakanda. CBSL took necessary actions to open an account in Central Bank general ledger account no 4898 namely Ministry of Finance & Planning –CDB Moragahakanda Development Project account as per the request of Department of External Resources. As the CBSL has agreed to operate the account in to which such monies are credited, in accordance with the instructions given by the Ministry of Irrigation & water Resources Management. On 29th of June 2012 US \$ 214.2 million received from CDB and first disbursement of US \$ 64,337,066.36 has been done on 24th August 2012 and the remaining balance is US \$ 149,862,933.64.

### 19. Deposits By Banks And Financial Institutions

Under the mechanism of Real Time Gross Settlement System (RTGS), participants which include licensed commercial banks, primary dealers and the Employee Provident Fund, can obtain the required funds for honouring payments under an interest free, fully collateralized intra-day liquidity facility. The participants are required to pledge tradable government securities

to obtain such intra-day liquidity facility. Advances under Intra-day Liquidity Facility represents such amounts advanced against tradable Government Securities, which stood at zero as at both year ends.

	2012 Rs. 000	2011 Rs. 000
<b>Deposits by Banks :</b>		
- Related Parties	84,679,924	75,337,875
- Others	81,572,604	70,925,920
	<u>166,252,528</u>	<u>146,263,795</u>
<b>Deposits by Financial Institutions</b>		
- Related Parties	242	117
- Others	35,608	5,273
	<u>35,850</u>	<u>5,390</u>
<b>Total Deposits by Banks and Other Financial Institutions</b>	<u>166,288,378</u>	<u>146,269,185</u>

## 20. Balances with Government and Government Entities

	2012 Rs. 000	2011 Rs. 000
Government Deposits	340,506	342,906
Government Agencies and Funds	359,122	1,456,124
	<u>699,628</u>	<u>1,799,030</u>

## 21. Securities Sold Under Agreement to Repurchase

	2012 Rs. 000	2011 Rs. 000
Government Securities	7,015,000	14,089,000
	<u>7,015,000</u>	<u>14,089,000</u>

## 22. Balances With Employee Benefit Plans

The Bank as a part of normal activities act as the bank for its employee benefit plans. The amounts held in credit of these separately administered employee benefit plans of the Bank, are as follows:

	2012 Rs. 000	2011 Rs. 000
Employee Provident Fund	150,895	4,396
Employee Retirement Pension Scheme Widows' /Widowers' & Orphans'	(397,808)	(481,216)
Pension Schemes	1,258,264	723,969
Payable in respect of Gratuity Scheme	24,369	10,007
Payable in respect of Medical Benefit Scheme	512,727	647,322
<b>Total Other Deposits</b>	<u>1,548,447</u>	<u>904,478</u>

## 23. Other Payables

Other Payables includes Rs.1,962.473 Mn (2011 -1,434.625 Mn) payable in respect of abandoned properties collected from the licensed banks & financial institutions under the Banking act directions no.05 of 2009- Identifying, Reporting, Transferring & Maintaining Abandoned Property of Licensed Commercial banks. In the event of any further claims on abandoned properties,

bank is liable to pay deposits so collected with interest. Hence the total deposit collected with the interest calculated on weighted average T. Bill interest rate is recorded as a liability of the bank.

Other payables also includes Rs. 27,463 Mn (2011 - Rs.23,142 Mn) deposit maintained by another Central Bank in relation to the SWAP facility.

## 24. Currency In Circulation

The Bank, as the sole currency issuing authority in Sri Lanka continued to perform the function of issuing legal tender currency. The amount of currency issued by the Bank and in circulation at respective balance sheet dates are as follows:

Denomination Coins:	2012 Rs. 000	2011 Rs. 000
1 cent	3,631	3,631
2 cent	5,702	5,702
5 cent	23,245	23,245
10 cent	39,209	39,209
25 cent	120,732	121,267
50 cent	185,378	185,505
1 rupee	702,536	660,639
2 rupee	998,102	920,287
5 rupee	2,981,784	2,776,439
10 rupee	1,275,959	848,538
<b>Commemorative coins</b>	<u>572,256</u>	<u>568,403</u>
	<u>6,908,534</u>	<u>6,152,865</u>

### Notes:

1 rupee	4,981	4,981
2 rupee	26,698	26,698
5 rupee	37,198	37,201
10 rupee	1,735,340	1,821,370
20 rupee	3,350,440	3,012,681
50 rupee	3,779,318	3,688,011
100 rupee	14,978,744	14,317,220
200 rupee	144,531	165,719
500 rupee	23,317,647	21,390,779
1000 rupee	101,046,102	105,362,876
2000 rupee	109,370,204	105,717,340
5000 rupee	53,360,405	31,535,620
	<u>311,151,608</u>	<u>287,080,496</u>

**Total Currency in Circulation** 318,060,142 293,233,361

## 25. Deferred Grants

	2012 Rs. 000	2011 Rs. 000
As at 01 January	3,468	4,605
Amortization during the year	(1,079)	(1,137)
<b>As at 31 December</b>	<u>2,389</u>	<u>3,468</u>

Deferred revenue is amortized over the period that matches with the depreciation policy of such assets.

## 26. Miscellaneous Liabilities And Accruals

Miscellaneous Liabilities and Accruals include the balances payable in the accounts payable, contract retention, deposits taken as refundable tender deposits and the penalties payable by the exchange control department.

## 27. Equity

### Nature of Equity Items

#### Capital Funds

**Contributed Capital** - The capital account represents the capital of the Bank in accordance with section 6 of the Monetary Law Act.

**Reserves Appropriated as Capital** : This Reserve is made up by transferring Rs.24,985 Mn out of the General Reserves in 2008, as per the Monetary Board decision of MB/F/22/12/2008. During March 2012 Rs. 10 Bn also has been transferred out of General Reserve as per MB decision MB/F/5/17/2012

**In addition to the Retained Earnings, reserves comprise the following;**

**International Revaluation Reserve (IRR)** : International Revaluation Reserve is a reserve established in accordance with section 41 of the Monetary Law Act which requires that any unrealised gain or loss arising from the revaluation of net assets and liabilities of CBSL in gold or foreign currency shall not be considered in computing the net profit of the bank, instead such profit or loss should be transferred to the International Reserve Revaluation.

**Market Revaluation Reserve (MRR) and other reserves:** Market Revaluation Reserve (MRR) was set up as per the Monetary Board decision of 30 January 2003, to transfer the price valuation gains from marking to market the foreign assets, in order to meet any adverse effects of volatilities in the international markets leading to adverse movements in market prices of the foreign financial assets. The Monetary Board has decided to build up this reserve to a maximum of 10% of the gross foreign reserves of the CBSL.

Other reserves include General reserve, Building Reserve and Credit Guarantee. General Reserve includes the amounts set a side from the retained earnings By the Monetary Board.

**CBSL Specific Reserves** : CBSL Specific Reserves includes the income earned from the investment of funds of Medical Benefit Support Fund (Pensioners) and Gratuity Fund.

**Net Fair Value/(Loss) on Available for Sale Securities and Allocated Gold Accounts** : For the year ended 31 March 2012 ,unrealized gains and losses on the revaluation of securities designated as available for sale & un-allocated gold accounts, have been transferred to this reserve.

**RTGS Sinking Fund** : This fund is built up with the charges collected from the participants for use of the RTGS system. The fund is limited to investments in treasury bills and bonds.

**Pension Fund Reserve** : This reserve is made up by transferring an additional Rs.3 Bn from 2007 profits to be used to meet any shortfalls in the pension fund given the vulnerability of the income generating capacity of the Bank, to external risks.

**Technical Advancement Reserve** : This reserve is built up from 2007 profits specifically to be used for technical advancement requirements, modification or upgrading of the IT systems currently used by the CBSL i.e., GL, RTGS,TDRMS,or,SSS.

**Provincial Development Credit Scheme** – During 2010 bank has commenced a refinance credit scheme for medium & long term development purposes for provinces by creating a fund from the profits, amounting to Rs. 2.9 Bn. Such loans are granted through Bank of Ceylon & Peoples' Bank.

The movements in the other reserves are as follows:

	Medium and Long Term Credit Reserve	Market valuation and Other reserves	CBSL Specific Reserves	RTGS Sinking Fund	IRR	Net Fair Value/(Loss) on Available for Sale Securities	Pension Fund Reserves	Technical Advancement Reserves	Provincial Development Credit Scheme	Total
	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000
<b>As at 1 January 2011</b>	11,425,000	16,181,033	731,898	518,847	42,411,491	4,722,711	3,000,000	1,000,000	2,900,000	82,890,980
Transfer of RTGS Income to RTGS Fund	-	-	-	153,751	-	-	-	-	-	153,751
Transfer of CBSL MBS Fund	-	-	87,039	-	-	-	-	-	-	87,039
Transfer of CBSL Gratuity Fund	-	-	6,045	-	-	-	-	-	-	6,045
Transfer of Profits to General Reserve & Building Reserve	-	10,142,076	-	-	-	-	-	-	-	10,142,076
Transfer of Profits to Market Valuation Reserve	-	4,884,031	-	-	-	-	-	-	-	4,884,031
Transfer of Net Foreign Exchange Revaluation Gain/ Loss	-	-	-	-	25,181,686	-	-	-	-	25,181,686
Net Fair value Loss on Available for sale Securities & gold	-	-	-	-	-	1,835,087	-	-	-	1,835,087
Transfer to reserve appropriated as capital	-	(10,000,000)	-	-	-	-	-	-	-	(10,000,000)
Transfer of Funds from General Reserve to Pension Fund	-	-	-	-	-	-	1,000,000	-	-	1,000,000
<b>As at 31 Dec 2012</b>	<b>11,425,000</b>	<b>21,207,140</b>	<b>824,982</b>	<b>672,598</b>	<b>67,593,177</b>	<b>6,557,798</b>	<b>4,000,000</b>	<b>1,000,000</b>	<b>2,900,000</b>	<b>116,180,695</b>

**28. Transfer Of Net Profits**

Under section 39 (c) of the Monetary Law Act No. 58 of 1949, as amended, the Bank's net profit, as determined in accordance with the Act, is paid to the government after making necessary appropriations to Reserves under section 38 of the Monetary Law Act. During the Period bank transferred Rs.10 Bn in respect of 2011 profit and Rs. 33 Bn in respect of 2012 profit to the Government.

**29. Interest Income From Financial Assets**

	2012 Rs. 000	2011 Rs. 000
<b>Interest Income from Foreign Currency Financial Assets</b>		
Cash and Cash Equivalents	1,934,021	1,681,786
Financial Assets	9,566,537	12,733,199
IMF Related Assets	4,616	20,131
<b>Total Interest Income from Foreign Currency Financial Assets</b>	<b>11,505,174</b>	<b>14,435,116</b>
<b>Interest Income from Local Currency Financial Assets</b>		
Sri Lanka Government Securities	25,441,705	4,280,118
Other Loans and Advances	515,897	488,651
<b>Total Net Interest Income from Local Currency Financial Assets</b>	<b>25,957,602</b>	<b>4,768,769</b>
<b>Total Interest Income from Financial Assets</b>	<b>37,462,776</b>	<b>19,203,885</b>

**30. Interest Expense On Financial Liabilities**

	2012 Rs. 000	2011 Rs. 000
<b>Interest Expense on Foreign Currency Financial Liabilities</b>		
Amount Payable to Asian Clearing Union	36,919	22,339
IMF Related Liabilities	4,639,495	3,123,782
Net SWAP Cost	(1,093,795)	620,598
Other Foreign Payable	120,347	144,112
<b>Total Interest Expense on Foreign Currency Financial Liabilities</b>	<b>3,702,966</b>	<b>3,910,831</b>
<b>Interest Expense on Local Currency Financial Liabilities</b>		
Securities Sold Under Agreements to Repurchase - Treasury Bills	897,233	1,592,397
- Treasury Bonds	-	2,645,210
Fees Paid on Bond Borrowing	-	105,483
CBSL Securities	-	42,073
Abandoned Property	194,307	156,810
<b>Total Interest Expense on Local Currency Financial Liabilities</b>	<b>1,091,540</b>	<b>4,541,973</b>
<b>Total Interest Expense on Financial Liabilities</b>	<b>4,794,506</b>	<b>8,452,804</b>

Bank has entered into a SWAP facility with a Foreign Central Bank from February 2009 for USD 200 Mn. A total sum of Rs 824.574 Mn (2011 - Rs.727.245 Mn) included in the Net SWAP Cost represent the cost incurred for SWAP facility with the Foreign Central Bank.

Bank has incurred a net cost of Rs. 1,695.884 Mn as sterilization cost (2011 - Rs. 4,372.856 Mn) in its activities to absorb the excess liquidity in the market. The sterilization cost is composed of the interest expenses incurred on securities sold under agreement to repurchased, fees paid on bond borrowing, CBSL securities and USD/LKR SWAP cost included in the Net SWAP cost netted off by interest income earned on the securities purchased under agreement to resale (Reverse Repurchase) included under interest income from Sri Lanka Government Securities, as discussed below.

	2012 Rs. 000	2011 Rs. 000
Interest expenses incurred on securities sold under agreement to repurchase	897,233	4,237,607
Fees Paid on Bond Borrowing	-	105,483
CBSL Securities	-	42,073
USD / LKR SWAP Cost / (Gain)	(1,454,050)	39,220
Less:		
Interest income earned on the securities purchase under agreement to resale	(1,139,067)	(51,527)
	<b>(1,695,884)</b>	<b>4,372,856</b>

**31. Other Income**

	2012 Rs. 000	2011 Rs. 000
Dividend Income - Others	14,792	12,534
Gain on Disposal of Property, Plant & Equipment	17,287	116
Gain on Disposal of Investments in Financial and Other Institutions	3,793	541
Amortization of Deferred Grant	929	1,137
Miscellaneous Income	939,218	655,071
<b>Total Other Income</b>	<b>976,019</b>	<b>669,399</b>

**32. Personnel Expenses**

	2012 Rs. 000	2011 Rs. 000
Wages and Salaries including EPF,ETF etc	2,860,792	2,274,045
Defined Contribution Plan Costs	426,622	334,593
Post Employee Defined Benefit Plan Costs	344,328	(358,609)
Impairment Loss due to reschedulement of Staff Loans	4,752	-
<b>Total Personnel Expenses</b>	<b>3,636,494</b>	<b>2,250,029</b>



<b>33. Administration Expenses</b>			<b>35. Reconciliation of Operating Profit with Operating Cash Flow</b>		
	2012 Rs. 000	2011 Rs. 000		2012 Rs. 000	2011 Rs. 000
Repairs and Maintenance	575,873	486,052	<b>Reported Net Profit from Operating Activities</b>	66,208,544	46,830,206
Operating Expenses for Rueter, Bloomberg, SWIFT etc.	133,642	81,904	<b>Add / (Less) Non-Cash Items</b>		
Traveling	87,628	85,006	Depreciation & Amortization	322,622	314,063
Rental Expenses	8,015	2,460	Interest Received – Local Currency		
Printing	30,999	30,589	– Investment Portfolio	(25,441,705)	(4,280,118)
Audit Fees - Current year	7,658	8,000	Bad Debts & Other Sundry Written Off	-	64,352
- Previous year under provision	-	86	Gross Unrealised Foreign Exchange (Gain) / Loss	(27,895,347)	(13,698,790)
Remuneration to Members of the Monetary Board	900	980	Amortization of Debentures	(7,273)	-
Interest Expense on CBSL			Other Provision	4,426,262	246,201
Provident Fund	147,174	-	Deferred Grants	(929)	(1,137)
Miscellaneous Expenses	386,406	532,633	Losses on revaluation	3,963	-
<b>Total Other Operating Expenses</b>	<b>1,378,295</b>	<b>1,227,710</b>	Amortization of PRGF Deposit	35,527	-
			Impairment Loss on Re-schedulement of staff loans	4,752	-
			Write off of CIP	313	-
			Removal of grant asset sold	(150)	-
			<b>Add/ (Less) Movements in Other Working Capital Items</b>		
			(Increase)/Decrease in Inventories	(457,512)	330,103
			(Increase)/Decrease in Interest Receivable	(2,623,493)	1,381,977
			Increase / (Decrease) in Miscellaneous Liabilities	(597,744)	584,346
			Increase / (Decrease) in Interest Payable	426,811	6,422
			Increase / (Decrease) in Other Receivable	(45,240)	(115,773)
			<b>Add / (Less) Investing and Financing Activities</b>		
			Income from investment	8,614	4,125
			Net Unrealised Market Value Changes	(296,049)	(4,884,031)
			<b>Net Cash Flow From Operating Activities</b>	<b>14,071,966</b>	<b>26,781,946</b>
			<b>36. Issues/(Withdrawals) of Circulation Currency On Government Transactions</b>		
				2012 Rs. 000	2011 Rs. 000
			Purchases of Government of Sri Lanka Securities	(10,868,300)	160,658,139
			Interest Received – Local Currency – Sri Lanka Government Securities	(23,207,197)	(1,550,509)
			Increase/(Decrease) in Advances to GOSL	16,548,830	16,864,190
			(Increase) / Decrease in Balances with Government and Government Entities	1,099,402	1,287,277
				<b>(16,427,265)</b>	<b>177,259,097</b>

During 2012, CBSL has paid Rs. 27.674 Mn (2011 - 324.370 Mn) which is included in miscellaneous expenses as legal fees for foreign lawyers who appeared in the arbitration proceedings on hedging case initiated by Deutsche Bank AG against Democratic Socialist Republic of Sri Lanka.

#### 34 Taxation

CBSL is not liable for the income tax as per the Inland Revenue (Amendment) Act No. 10 of 2006 section 7b (xvi) and the With Holding Tax paid by the bank treated as the final tax paid to IRD. From 2013 CBSL is not liable to pay Economic Service Charge.

As per the Inland Revenue (Amendment) Act, No. 10 of 2007, dividend or interest will be liable to 10% withholding tax at the time of payment or crediting. The withholding tax on the interest income on the Government Securities is based on the weighted average yield rate of the closest primary auction adjusted to the days to maturity.

During the period an amount of Rs. 2,405.694 Mn (2011 – Rs. 481.593 Mn) was expensed in relation to such withholding tax, payable on interest income of Rs. 25,441.705 Mn (2011 – Rs. 4,280.118 Mn) & dividend income of Rs. 14.792 Mn (2011 – Rs. 12.534 Mn). In addition, the Bank paid Economic Service Charge amounting to Rs. 120 Mn during the year of 2012 (2011 – Rs. 120 Mn).

<b>37. Net Issues/(Withdrawals) or Circulation Currency on Bank and Financial Institutions Transactions</b>			<b>38. Closing Cash and Cash Equivalents</b>			
	2012 Rs. 000	2011 Rs. 000		2012 Rs. 000	2011 Rs. 000	
(Increase)/Decrease in Deposits by Banks and Financial Institutions	<u>(19,325,888)</u>	<u>(41,477,740)</u>	<b>Foreign Currency Assets</b>			
			Cash Balances with Foreign Banks	<u>235,278,133</u>	<u>303,551,702</u>	
				<u>235,278,133</u>	<u>303,551,702</u>	
<b>39. Concentrations of Funding</b>						
The Bank's significant end-of-year concentrations of funding were as follows.						
	Total Rs. 000	Sri Lanka Government Rs. 000	Sri Lanka Public Rs. 000	Sri Lanka Commercial Banks Rs. 000	Supra- national Financial Institutions Rs. 000	Other Rs. 000
<b>As at 31 December 2012</b>						
<b>Foreign Currency Financial Liabilities</b>						
Amount Payable to Banks and Financial Institutions	2,619,847	-	-	-	839,009	1,780,838
Derivative Financial Instruments	3,257,119	-	-	3,207,000	-	50,119
Amount Payable to Asian Clearing Union	28,953,955	-	-	-	-	28,953,955
IMF Related Liabilities	467,642,196	-	-	-	467,642,196	-
Other Foreign Payables	64,520,662	62,381,490	-	1,547,781	551,034	40,357
<b>Total Foreign Currency Financial Liabilities</b>	<u>566,993,779</u>	<u>62,381,490</u>	<u>-</u>	<u>4,754,781</u>	<u>469,032,239</u>	<u>30,825,269</u>
<b>Local Currency Financial Liabilities</b>						
Deposits by Banks and Financial Institutions	166,288,378	-	-	166,252,528	-	35,850
Balances with Government and Government Entities	699,628	698,965	663	-	-	-
Securities Sold Under Agreements to Repurchase	7,015,000	-	-	7,015,000	-	-
Balances with Employee Benefits Plan	1,548,447	-	-	-	-	1,548,447
Other Payables	31,939,398	31,168	-	182,000	-	31,726,230
<b>Total Local Currency Financial Liabilities</b>	<u>207,490,851</u>	<u>730,133</u>	<u>663</u>	<u>173,449,528</u>	<u>-</u>	<u>33,310,527</u>
<b>Total Financial Liabilities</b>	<u>774,484,630</u>	<u>63,111,623</u>	<u>663</u>	<u>178,204,309</u>	<u>469,032,239</u>	<u>64,135,796</u>
<b>Other Liabilities</b>						
Currency in Circulation	318,060,142	-	318,060,142	-	-	-
Deferred Grants	2,389	-	-	-	-	2,389
Miscellaneous Liabilities and Accruals	143,916	14,172	-	-	-	129,744
<b>Total Other Liabilities</b>	<u>318,206,447</u>	<u>14,172</u>	<u>318,060,142</u>	<u>-</u>	<u>-</u>	<u>132,133</u>
<b>Total Liabilities</b>	<u>1,092,691,077</u>	<u>63,125,795</u>	<u>318,060,805</u>	<u>178,204,309</u>	<u>469,032,239</u>	<u>64,267,929</u>
<b>Comparative Figures as at 31 December 2011 are as Follows;</b>						
	Total Rs. 000	Sri Lanka Govern- ment Rs. 000	Sri Lanka Public Rs. 000	Sri Lanka Commercial Banks Rs. 000	Supra- national Financial Institutions Rs. 000	Other Rs. 000
<b>As at 31 December 2011</b>						
<b>Foreign Currency Financial Liabilities</b>						
Amount Payable to Banks and Financial Institutions	937,712	-	-	-	411,840	525,872
Derivative Financial Instruments	1,041,597	-	-	212,575	12,096	816,926
Amount Payable to Asian Clearing Union	90,032,085	-	-	-	-	90,032,085
IMF Related Liabilities	328,772,419	-	-	-	328,772,419	-
Other Foreign Payables	58,621,764	-	-	1,995,232	414,478	56,212,054
<b>Total Foreign Currency Financial Liabilities</b>	<u>479,405,577</u>	<u>-</u>	<u>-</u>	<u>2,207,807</u>	<u>329,610,833</u>	<u>147,586,937</u>

<b>Local Currency Financial Liabilities</b>						
Deposits by Banks and Financial Institutions	146,269,185	-	-	146,263,795	-	5,390
Balances with Government and Government Entities	1,799,030	1,797,934	1,096	-	-	-
Securities Sold Under Agreements to Repurchase	14,089,000	-	-	13,850,000	-	239,000
Balances with Employee Benefits Plan	904,478	-	-	-	-	904,478
Other Payable	28,041,215	15,582	-	182,000	-	27,843,633
<b>Total Local Currency Financial Liabilities</b>	<b>191,102,908</b>	<b>1,813,516</b>	<b>1,096</b>	<b>160,295,795</b>	<b>-</b>	<b>28,992,501</b>
<b>Total Financial Liabilities</b>	<b>670,508,485</b>	<b>1,813,516</b>	<b>1,096</b>	<b>162,503,602</b>	<b>329,610,833</b>	<b>176,579,438</b>
<b>Other Liabilities</b>						
Currency in Circulation	293,233,361	-	293,233,361	-	-	-
Deferred Grants	3,468	-	-	-	-	3,468
Miscellaneous Liabilities and Accruals	884,048	25,031	-	-	-	859,017
<b>Total Other Liabilities</b>	<b>294,120,877</b>	<b>25,031</b>	<b>293,233,361</b>	<b>-</b>	<b>-</b>	<b>862,485</b>
<b>Total Liabilities</b>	<b>964,629,362</b>	<b>1,838,547</b>	<b>293,234,457</b>	<b>162,503,602</b>	<b>329,610,833</b>	<b>177,441,923</b>

#### 40. Risk Management

The Central Bank together with the Monetary Board has two statutory objectives, i.e., economic and price stability and financial system stability and it has wide statutory powers to implement economic and financial policies to secure its objectives. Therefore, the effectiveness of the risk management or performance of the Bank cannot be measured by the amount of its profit as the Bank has policy-making powers to acquire financial assets by printing money and to influence interest rates, exchange rate and credit. Therefore, the profit or loss is only a neutral financial outcome of the activities of the Bank and its operations and policies are not geared at profit. However, in the course of carrying out its functions, the Bank is faced with risks such as reputational risks, financial risks and operational risks. The bank's management seeks to ensure that strong and effective risk management and control systems are in place for assessing, monitoring and managing risk exposure.

The Monetary Board is ultimately responsible for identifying and controlling risks. The Board has delegated this task to several committees and units/departments to ensure effective management and controlling of risk takes place.

The high level Risk Management Committee, chaired by the Governor comprises all Deputy Governors, Assistant Governors and heads of key departments involved in the risk management function. The Committee has the overall responsibility for the development of the risk strategy and implementing principles, frameworks, policies and limits. It is responsible to ensure that mechanisms are in place to identify potential risks and to take appropriate actions to mitigate such risks. The Committee also seeks to ensure that all necessary internal controls are in place and the risks related to the automated systems used by the Bank, such as the Real-Time Gross Settlement System (RTGS), the Script less Securities Settlement System (SSS), the

General Ledger System and the Treasury Dealing Room Management System (TDRMS) are controlled.

The reputational risks mainly arise from the Bank's policy-making functions in the event such policies are not effective enough to yield benefits to the economy or the general public. For example, its reputation risks are high during the times of high inflation or failures of financial institutions under its regulation. The Bank provides human and other resources to the departments responsible for economic and financial policies to ensure that the policies are implemented effectively and such policies are communicated adequately.

The main financial risks to which the Central Bank is exposed to are credit risk, foreign exchange risk and interest rate risk. A significant proportion of these risks arise from the management of foreign reserves of the Bank. The International Operations Department (IOD) of the Bank manages the foreign currency portfolio. The Middle Office of the IOD is responsible for the monitoring and management of financial risks relating to the banks' foreign assets portfolio.

The Foreign Reserves Management Committee appointed by the Monetary Board has the responsibility for ensuring that the foreign reserves management function is carried out effectively and efficiently. All policy measures including those in relation to risk management is considered by the Committee and recommended to the Monetary Board for adoption. A comprehensive set of guidelines incorporating risk mitigation policies have been issued to the dealers involved in the reserves management function.

A Counter party Credit Risk Management System is used by the IOD to manage the credit risk of the foreign assets portfolio based on the credit ratings of the investments and the counter parties. Interest rate risk or the exposure of the Bank's foreign assets portfolio to movements in the interest rate is managed through the appropriate adjustments of the duration of the portfolio. The foreign

exchange risk or the capital loss as a consequence of fluctuations in the exchange rates is managed mainly through diversification of investment currencies. In the management of foreign reserves, minimizing liquidity risk is the prime consideration in order to maintain an effective foreign exchange intervention capability. Policies for managing the credit, interest rate, foreign exchange and liquidity risks are outlined in sections 40.1, 40.2, 40.3 & 40.4, respectively.

The internal controls and the risk management processes are audited annually by the Management Audit Department (MAD) of the Bank. It examines the adequacy of the procedures and the Bank's compliance with the procedures. All departments are subject to periodic internal audit review. The MAD reports directly to the Governor and reports its findings and recommendations to the Audit Committee.

The Audit Committee chaired by a Monetary Board member, oversees the auditing arrangements by the MAD as well as the external auditors. The Committee reviews the internal audit function and has direct access to the external auditor. The primary functions of the Audit Committee is to advise and assist the Monetary Board in managing an internationally acceptable financial reporting system, in order to provide accurate, appropriate and timely information to the general public. The Committee reports to the Monetary Board on its activities on a regular basis.

The Bank is subject to an external audit by the Auditor General under the Monetary Law Act sections 42 & 43. The Auditor General in turn has obtained the services of a firm of Chartered Accountants M/S Ernst & Young to carry out an audit under International Standards of Auditing to ensure compliance with the International Financial Reporting Standards.

#### 40.1 Credit Risk

(a) The Bank's significant end-of-year concentrations of credit exposure by geographical area (based on the entity's country of ownership) were as follows.

Concentrations of credit Exposure by geographical area	2012 Rs. 000	2011 Rs. 000
Sri Lanka	299,361,934	288,634,753
USA	307,264,213	260,181,072
Japan	98,907,157	52,747,385
Britain	145,154,489	108,201,703
Europe	101,744,534	183,441,677
Supranational	140,089,264	122,497,146
Other	89,393,860	48,369,072
<b>Total Financial Assets</b>	<b>1,181,915,451</b>	<b>1,064,072,808</b>

#### (b) Concentrations of Credit Exposure

The Bank's significant end-of-year concentrations of credit exposure by Institution type were as follows.

	2012 Rs. 000	2011 Rs. 000
Governments	916,429,708	578,677,316
Supranational Financial Institutions	140,089,264	122,497,146
Foreign Banks and Financial Institutions	116,674,935	356,785,479
Sri Lanka Banks & Financial Institutions	4,235,915	31,490
Other	4,485,629	6,081,377
<b>Total Financial Assets</b>	<b>1,181,915,451</b>	<b>1,064,072,808</b>

#### (c) Credit Exposure by Credit Rating

The following table presents the credit ratings of respective financial assets or issuers, based on the ratings of Standard and Poor's, Fitch Ratings and Moody's ratings. Under Standard & Poor's ratings and Fitch Ratings, AAA is the highest quality rating possible and indicates the lowest expectations of credit risk. It is assigned only in the case of exceptionally strong capacity for timely payment of financial commitment. AA is very high quality grade, indicating very low expectation of credit risk, and A is an upper medium grade, indicating a low expectation of credit risk; BBB is the lowest investment grade rating, indicating that there is currently a low expectation of credit risk and exhibits adequate protection parameters, ratings lower than AAA can be modified by + or - signs to indicate relative standing within the major categories. NR indicates Standard and Poor's have not rated the entity, Moody's or Fitch.

Credit Exposure by Credit Rating	Credit Rating	2012 Rs. 000	%	2011 Rs. 000	%
<b>Cash &amp; Cash Equivalents</b>					
Federal Reserve Bank - USA/Reserve Bank of Australia/Bank for International Settlements/ Bank of Japan/Deutsche Bundes Bank/Bank of England/SRB/BC/RBNZ		192,558,429	16.29%	217,909,863	20.48%
	AAA	-	-	2,267,668	0.21%
	AA	284,060	0.02%	-	-
	AA-	26,457,182	2.24%	75,192	0.01%
	A+	15,875,460	1.34%	5,324,713	0.50%
	A-	-	-	25,921	0.00%
	A	157	0.00%	10,977	0.00%
	BBB+	29,561	0.00%	-	-
	NR	73,284	0.02%	77,937,368	7.32%
		<b>235,278,133</b>	<b>19.91%</b>	<b>303,551,702</b>	<b>28.53%</b>
<b>Derivative Financial Instruments</b>					
Federal Reserve Bank - USA/Reserve Bank of Australia/Bank for International Settlements/ Bank of Japan /Deutsche Bundes Bank/Bank of England /SRB/BC/RBNZ		-	-	136,504	0.01%
	AA-	-	-	837,196	0.08%
	A+	-	-	395,695	0.04%
	A	-	-	1,315,922	0.12%
	A-	-	-	40,134	0.00%
	NR	1,605,296	0.15%	41,643	0.00%
Locally Rated	AAA	1,064,600	0.09%	-	-
	AA+	37,250	0.00%	22,850	0.00%
	AA	630,600	0.05%	-	-
	AA-	599,325	0.05%	2,025	0.00%
	A+	-	-	2,365	0.00%
	A	52,630	0.00%	-	-
		<b>3,989,701</b>	<b>0.34%</b>	<b>2,794,334</b>	<b>0.26%</b>
<b>Foreign Currency Trading/ Available for Sale Securities</b>					
Federal Reserve Bank - USA/Reserve Bank of Australia/Bank for International Settlements/ Bank of Japan /Deutsche Bundes Bank/Bank of England /SRB/BC/RBNZ					
	AAA	297,153,071	25.14%	243,614,704	22.89%
	AA+	196,972,123	16.67%	88,610,553	8.33%
	AA-	10,347,101	0.88%	25,859,634	2.43%
	A+	19,184,259	1.62%	-	-
	CC	-	-	557,522	0.05%
	NR	17,621,979	1.49%	4,878,554	0.46%
		<b>541,278,533</b>	<b>45.80%</b>	<b>363,520,967</b>	<b>34.16%</b>
Sesurities at Fair valur through Profit and Loss	A+	14,795,761	1.25%	13,150,196	1.24%
		<b>14,795,761</b>	<b>1.25%</b>	<b>13,150,196</b>	<b>1.24%</b>
IMF Related Assets	AAA	81,352,282	6.88%	73,090,516	6.87%
		<b>81,352,282</b>	<b>6.88%</b>	<b>73,090,516</b>	<b>6.87%</b>

<b>40.1 Credit Risk (Continued)</b>					
<b>(c) Credit Exposure by Credit Rating (Continued)</b>	<b>Credit Rating</b>	<b>2012 Rs. 000</b>	<b>%</b>	<b>2011 Rs. 000</b>	<b>%</b>
<b>Other Foreign Receivables</b>	AAA	600	0.00%	17,528,616	1.65%
	AA+	-	-	1,280,421	0.12%
	AA	46,231	0.00%	-	-
	A	-	-	552,775	0.05%
	BBB	2,529,308	0.21%	-	-
	NR	5,667,373	0.49%	19	0.00%
		<u>8,243,512</u>	<u>0.70%</u>	<u>19,361,831</u>	<u>1.82%</u>
<b>Total Foreign Currency Financial Assets</b>		<u>884,937,922</u>	<u>74.87%</u>	<u>775,469,546</u>	<u>72.88%</u>
<b>Local Currency Financial Assets</b>					
Sri Lanka Government Securities	B+	175,251,772	14.83%	183,885,564	17.28%
Loans to Government	B+	111,291,843	9.42%	94,743,013	8.90%
Loans to Other Institutions	AA+	1,756,213	0.15%	2,313,533	0.22%
	AA-	62,921	0.01%	-	-
	A-	23,572	0.00%	-	-
	BBB+	1	0.00%	-	-
	BB+	440	0.00%	-	-
	NR	1,090	0.00%	-	-
Other Local Receivable	B+	2,501,728	0.21%	2,399,849	0.23%
	NR	468,371	0.04%	524,179	0.05%
Investments in Financial and Other Institutions	NR	41,095	0.00%	41,211	0.00%
Other Assets	B+	1,799,394	0.15%	3,202,868	0.30%
	NR	3,779,089	0.32%	1,493,045	0.14%
<b>Total Local Currency Financial Assets</b>		<u>296,977,529</u>	<u>25.13%</u>	<u>288,603,262</u>	<u>27.12%</u>
<b>Total Financial Assets</b>		<u>1,181,915,451</u>	<u>100.00%</u>	<u>1,064,072,808</u>	<u>100.00%</u>
<b>(d) Summary by Major Credit Category</b>					
<b>Foreign Currency Financial Assets</b>					
Federal Reserve Bank - USA/Reserve Bank of Australia/Bank for International Settlements/ Bank of Japan /Deutsche Bundes Bank/Bank of England /SRB/BC/RBNZ					
		192,558,429	16.29%	218,046,368	20.49%
IMF Related Assets		81,352,282	6.88%	73,090,517	6.87%
	AAA	297,153,671	25.14%	263,410,988	24.75%
	AA+/-	234,106,698	19.81%	116,662,996	10.96%
	A+/-	49,855,636	4.22%	20,816,333	1.96%
	BBB+/-	2,558,869	0.22%	-	-
	CC	-	-	557,522	0.05%
	NR	24,967,932	2.12%	82,857,582	7.79%
Locally Rated	AAA	1,064,600	0.09%	-	-
	AA+	37,250	0.00%	22,850	0.00%
	AA	630,600	0.05%	-	-
	AA-	599,325	0.05%	2,025	0.00%
	A	52,630	0.00%	2,365	0.00%
<b>Total Foreign Currency Financial Assets</b>		<u>884,937,922</u>	<u>74.87%</u>	<u>775,469,546</u>	<u>72.88%</u>

Local Currency Financial Assets					
	AA+	1,756,213	0.15%	-	-
	AA-	62,921	0.01%	-	-
	A-	23,572	0.00%	-	-
	BBB+	1	0.00%	-	-
	BB+	440	0.00%	-	-
	B+	290,844,737	24.61%	282,521,471	26.55%
	NR	4,289,645	0.36%	6,081,791	0.57%
<b>Total Local Currency Financial Assets</b>		<b>296,977,529</b>	<b>25.13%</b>	<b>288,603,262</b>	<b>27.12%</b>
<b>Total Financial Assets</b>		<b>1,181,915,451</b>	<b>100.00%</b>	<b>1,064,072,808</b>	<b>100.00%</b>

## 40.2 Interest Rate Risk

### (a) Foreign Currency Interest rate sensitivity

Interest rate risk is the risk of loss arising from the changes in interest rates.

The interest rate sensitivity of the Fixed Income Securities portfolio measured by the potential loss incurred due to a rise in interest rate by 10 basis points is another risk measure used by the Bank Sensitivity of the risk exposure of the segmented Fixed Income Securities Portfolio is given below.

Portfolio Segment	Potential Loss ( US\$ Mn)	
	2012	2011
Trading	7.1	5.52
Available for Sale	16.54	9.94
<b>Total</b>	<b>23.64</b>	<b>15.46</b>

The Middle Office of IOD manages the interest rate risk of the foreign assets portfolio by employing the following strategies:

- i) While the interest rate sensitivity measures the effect of a change in the interest rates on the foreign assets portfolio, CBSL uses Modified Duration (MD) as a measurement of interest rate risk which considers interest rates as well as the duration of an investment. The MD measures the change in price of a security for a given change in the interest rates (yield). A higher MD indicates a higher risk. Hence, the bank set an appropriate MD from time to time considering the developments in the financial markets, portfolio characteristics and the risk appetite of the Bank. As a general practice the upper limit for foreign exchange reserve holdings of Central Banks is specified around 2.5(overall), while it could vary downward depending on the market outlook and risk appetite of the Central Bank. By maintaining the MD within the upper limits set by the Bank, the interest rate risk and the duration risk of the foreign asset portfolio is managed. The MDs of the foreign assets portfolio, are tabulated below:

### Modified Duration

Investment Segment	Modified Duration	
	2012	2011
Money Market (Fixed and call deposits)	0.01	0.01
Capital Market (Fixed Income Securities)	5.55	4.66
<b>Overall</b>	<b>3.58</b>	<b>2.70</b>

- ii) Since the modified duration does not account for large changes in prices, another measure used for management of interest rate risk of the foreign reserves portfolio is convexity. Convexity measures the extent of deviation in bond price-yield curve from a straight line representing duration. It allows improving the duration approximation for bond price changes. Convexity is a change in Duration for a change in yield. It measures the predictive error of Modified Duration. In other words, it is the second derivative of a security's price with respect to its yield, divided by the security's prices. A security exhibits positive convexity when its price raise more for a downward move in its yield than its price decline for an equal upward move in its yield.

### Convexity of the segmented Fixed Income

#### Securities portfolio

Portfolio Segment	Potential Loss (US\$ Mn)	
	2012	2011
Trading	0.45	0.45
Available for Sale	0.42	0.31
<b>Total</b>	<b>0.43</b>	<b>0.35</b>

## 40.2 Interest Rate Risk (Contd.)

### iii) Value at Risk

VaR summarizes in a single number the downside risk of the portfolio, under normal market conditions, from financial market movements. Therefore, VaR is the maximum loss over a target horizon such that there is a low, pre-specified probability that the actual loss will be larger. Loss: VaR gives us a number, in terms of money, which can be aggregated across risks and positions. Probability: If there is a 5% probability of actual losses being greater than VaR, losses will exceed VaR only on 5 out of 100 'normal' trading days. This means that, VaR is the smallest amount that could be lost on those 5 days. It does not measure the worst possible loss, because that is not calculable Target Horizon: Should correspond to the longest period needed for orderly portfolio liquidation. Thus, Portfolio is frozen for the horizon. From the various methods of calculating VaR for a portfolio, the Bank uses Montecarlo simulation method to calculate VaR number for 2 weeks period at 99% confidence interval. This strategy was implemented by the Bank from March 2011.

Portfolio Segment	Value at Risk (VaR) US\$ Mn	
	2012	2011
Trading	17.01	21.48
Available for Sale	36.62	34.39
Total	53.63	55.87

### iv) Trading & open position Limits

Bank assigns specific dealer limits on intra-day and overnight position limits for individual dealers by way of "Dealing Authority "

### (b) Local Currency Interest Rate Sensitivity

The local Treasury bills portfolio is recorded in the Statement of Financial Position of the CBSL at amortized cost as it represents loans provided to the Government of Sri Lanka. This portfolio is not an investment portfolio, as the Bank does not purchase Treasury bills with the intention of earning an interest income. The bank purchases or sells Treasury bills to inject rupee liquidity into the domestic market or to absorb liquidity from the market in the course of carrying out its monetary policy operations in relation to one of its core objectives, namely maintaining economic and price stability. Hence, the volume of Treasury Bills in the Bank's portfolio is determined by its monetary policy operations. In addition, the basic interest rates in the rupee market, namely, the Repo rate and the Reverse Repo rate are policy rates determined by the Bank in the course of implementing its monetary policy. Moreover, the banks actions in injecting rupee liquidity or absorbing liquidity from the market have a significant impact on general rupee market interest rates. Thus, changes in the interest income earned from the Treasury Bill portfolio, which arise from changes in the volume of the Bank's Treasury Bill portfolio, as well as changes in interest rates, are primarily a consequence of the bank's monetary policy actions, rather than due to investment decisions. Therefore, the bank does not consider interest rate sensitivities arising from local currency assets.



<b>40.2 Interest Rate Risk (Continued)</b>							
<b>(c) Assets and liabilities will mature or re-price within the following Periods</b>							
<b>Foreign Currency Interest Rate Sensitivity Gap:</b>	<b>Weighted Ave. Int. Rate %</b>	<b>2012 Total Rs. 000</b>	<b>6 Months or Less Rs. 000</b>	<b>6 to 12 Months Rs. 000</b>	<b>1 to 2 Years Rs. 000</b>	<b>2 to 5 Years Rs. 000</b>	<b>Over 5 Years Rs. 000</b>
<b>Interest Sensitive Foreign Currency Financial Assets</b>							
Cash & Cash equivalents	0.59	235,278,133	235,278,133	-	-	-	-
Securities at Fair Value through Profit and Loss and Available for Sale Investments	1.32	541,278,533	8,317,820	13,352,336	30,504,343	182,321,351	306,782,683
IMF related assets	0.02	9,837,987	9,837,987	-	-	-	-
<b>Total Interest Sensitive Foreign Currency Financial Assets</b>		<b>786,394,653</b>	<b>253,433,940</b>	<b>13,352,336</b>	<b>30,504,343</b>	<b>182,321,351</b>	<b>306,782,683</b>
<b>Non Interest Sensitive Foreign Currency Financial Assets</b>							
IMF Related assets		71,514,295	-	-	-	-	71,514,295
Derivative Financial Instruments		3,989,701	3,989,701	-	-	-	-
Receivables		8,243,512	8,243,512	-	-	-	-
Securities at Fair Value through Profit and Loss		14,795,761	14,795,761	-	-	-	-
<b>Total non Interest Sensitive Foreign Currency Financial Assets</b>		<b>98,543,269</b>	<b>27,028,974</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>71,514,295</b>
<b>Total Foreign Currency Financial Assets</b>		<b>884,937,922</b>	<b>280,462,914</b>	<b>13,352,336</b>	<b>30,504,343</b>	<b>182,321,351</b>	<b>378,296,978</b>
<b>Interest Sensitive Foreign Currency Financial Liabilities</b>							
IMF related liabilities	0.0023	319,006,144	21,271,614	37,006,552	92,516,379	168,211,599	-
Amounts payable to Asian Clearing Union	0.17	28,953,955	28,953,955	-	-	-	-
<b>Total Interest Sensitive Foreign Currency Financial Liabilities</b>		<b>347,960,099</b>	<b>50,225,569</b>	<b>37,006,552</b>	<b>92,516,379</b>	<b>168,211,599</b>	<b>-</b>
<b>Non Interest Sensitive Foreign Currency Financial Liabilities</b>							
Payables		2,619,847	2,619,847	-	-	-	-
Derivative Financial Instruments		3,257,119	3,257,119	-	-	-	-
IMF related liabilities		148,636,052	-	-	-	-	148,636,052
Commercial bank capital in foreign currency		1,547,781	-	-	-	-	1,547,781
Other foreign Liabilities		62,972,881	62,972,881	-	-	-	-
<b>Total Non Interest Sensitive Foreign Currency Financial Liabilities</b>		<b>219,033,680</b>	<b>68,849,847</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>150,183,833</b>
<b>Total Foreign Currency Financial Liabilities</b>		<b>566,993,779</b>	<b>119,075,416</b>	<b>37,006,552</b>	<b>92,516,379</b>	<b>168,211,599</b>	<b>150,183,833</b>
<b>Foreign Currency Interest Rate Sensitivity Gap</b>		<b>438,434,554</b>	<b>203,208,371</b>	<b>(23,654,216)</b>	<b>(62,012,036)</b>	<b>14,109,752</b>	<b>306,782,683</b>

<b>40.2 Interest Rate Risk (Continued)</b>							
	Weighted Avg. Int. Rate %	2012 Total Rs. 000	6 Months or Less Rs. 000	6 to 12 Months Rs. 000	1 to 2 Years Rs. 000	2 to 5 Years Rs. 000	Over 5 Years Rs. 000
<b>Interest Sensitive Local Currency Financial Assets</b>							
Sri Lanka Government Securities	11.95	148,672,772	138,508,882	10,163,890	-	-	-
Treasury Bills and Bond Reverse Repo	9.50	26,579,000	26,579,000	-	-	-	-
Loans to Other Institutions	7.27	1,844,237	387,906	358,126	665,457	432,748	-
Other assets - Staff Loans	4.00	3,771,816	67,431	68,566	140,707	452,432	3,042,680
- Others	7.32	1,806,667	240,892	77,207	596,426	884,869	7,273
<b>Total Interest Sensitive Local Currency Financial Assets</b>		<b>182,674,492</b>	<b>165,784,111</b>	<b>10,667,789</b>	<b>1,402,590</b>	<b>1,770,049</b>	<b>3,049,953</b>
<b>Non Interest Sensitive Local Currency Assets</b>							
Loans to Government		111,291,843	111,291,843	-	-	-	-
Receivables		2,970,099	2,970,099	-	-	-	-
Investment in Equity Securities - Available for Sale		41,095	-	-	-	-	41,095
<b>Total non Interest Sensitive Local Currency Assets</b>		<b>114,303,037</b>	<b>114,261,942</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>41,095</b>
<b>Total Local Currency Assets</b>		<b>296,977,529</b>	<b>280,046,053</b>	<b>10,667,789</b>	<b>1,402,590</b>	<b>1,770,049</b>	<b>3,091,048</b>
<b>Interest Sensitive Local Currency Financial Liabilities</b>							
Securities sold under agreement to repurchase	7.50	7,015,000	7,015,000	-	-	-	-
<b>Total Interest Sensitive Local Currency Financial Liabilities</b>		<b>7,015,000</b>	<b>7,015,000</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Non Interest Sensitive Local Currency Liabilities</b>							
Balances with Banks and Financial Institutions		166,288,378	166,288,378	-	-	-	-
Balances with Government and Government Entities		699,628	699,628	-	-	-	-
Balances with Employee Benefit Plans		1,548,447	1,548,447	-	-	-	-
Other Payables		31,939,398	31,939,398	-	-	-	-
<b>Total Non interest sensitive Local currency financial liabilities</b>		<b>200,475,851</b>	<b>200,475,851</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Total Local currency financial liabilities</b>		<b>207,490,851</b>	<b>207,490,851</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Local Currency Interest Rate Sensitivity Gap</b>		<b>175,659,492</b>	<b>158,769,111</b>	<b>10,667,789</b>	<b>1,402,590</b>	<b>1,770,049</b>	<b>3,049,953</b>

<b>40.2 Interest Rate Risk (Continued)</b>							
<b>( c ) Assets and liabilities will mature or re- price within the following periods</b>							
Comparative figures as at 31 December 2011 were as follows							
<b>Foreign Currency Interest Rate Sensitivity Gap:</b>	<b>Weighted Ave. Int. Rate %</b>	<b>2011 Total Rs. 000</b>	<b>6 Months or Less Rs. 000</b>	<b>6 to 12 Months Rs. 000</b>	<b>1 to 2 Years Rs. 000</b>	<b>2 to 5 Years Rs. 000</b>	<b>Over 5 Years Rs. 000</b>
<b>Interest Sensitive Foreign currency financial assets</b>							
Cash & Cash equivalents	0.11	303,551,702	303,551,702	-	-	-	-
Securities at Fair Value through Profit and Loss and Available for Sale Investments	1.90	363,520,966	35,005,726	23,817,947	18,919,909	104,958,567	180,818,817
IMF related assets	0.11	8,870,519	8,870,519	-	-	-	-
<b>Total Interest Sensitive Foreign Currency Financial Assets</b>		<b>675,943,187</b>	<b>347,427,947</b>	<b>23,817,947</b>	<b>18,919,909</b>	<b>104,958,567</b>	<b>180,818,817</b>
<b>Non Interest Sensitive Foreign Currency Financial Assets</b>							
IMF Related assets		64,219,998	-	-	-	-	64,219,998
Derivative Financial Instruments		2,794,334	2,794,334	-	-	-	-
Receivables		19,361,831	19,361,831	-	-	-	-
Securities at Fair Value through Profit and Loss		13,150,196	13,150,196	-	-	-	-
<b>Total Non Interest Sensitive Foreign Currency Financial Assets</b>		<b>99,526,359</b>	<b>35,306,361</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>64,219,998</b>
<b>Total Foreign Currency Financial Assets</b>		<b>775,469,546</b>	<b>382,734,308</b>	<b>23,817,947</b>	<b>18,919,909</b>	<b>104,958,567</b>	<b>245,038,815</b>
<b>Interest Sensitive Foreign Currency Financial Liabilities</b>							
IMF related liabilities	0.01	195,693,187	972,534	5,490,711	52,178,549	137,051,393	-
Amounts payable to Asian Clearing Union	0.02	90,032,085	90,032,085	-	-	-	-
<b>Total Interest Sensitive Foreign Currency Financial Liabilities</b>		<b>285,725,272</b>	<b>91,004,619</b>	<b>5,490,711</b>	<b>52,178,549</b>	<b>137,051,393</b>	<b>-</b>
<b>Non Interest Sensitive Foreign Currency Financial Liabilities</b>							
Payables		937,712	937,712	-	-	-	-
Derivative Financial Instruments		1,041,597	1,041,597	-	-	-	-
IMF related liabilities		133,079,232	-	-	-	-	133,079,232
Commercial bank capital in foreign currency		1,995,232	-	-	-	-	1,995,232
Other foreign liabilities		56,626,532	56,626,532	-	-	-	-
<b>Total Non Interest Sensitive Foreign Currency Financial Liabilities</b>		<b>193,680,305</b>	<b>58,605,841</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>135,074,464</b>
<b>Total Foreign Currency Financial Liabilities</b>		<b>479,405,577</b>	<b>149,610,460</b>	<b>5,490,711</b>	<b>52,178,549</b>	<b>137,051,393</b>	<b>135,074,464</b>
<b>Foreign Currency Interest Rate Sensitivity Gap</b>		<b>390,217,915</b>	<b>256,423,328</b>	<b>18,327,236</b>	<b>(33,258,640)</b>	<b>(32,092,826)</b>	<b>180,818,817</b>

**40.2 Interest Rate Risk (Continued)****(c) Assets and liabilities will mature or re- price within the following periods.**

Comparative figures as at 31 December 2011 were as follows;

	Weighted Avg. Int. Rate %	2011 Total Rs. 000	6 Months or Less Rs. 000	6 to 12 Months Rs. 000	1 to 2 Years Rs. 000	2 to 5 Years Rs. 000	Over 5 Years Rs. 000
<b>Interest Sensitive Local Currency Financial Assets</b>							
Sri Lanka Government Securities	7.56	164,421,565	143,326,695	21,094,870	-	-	-
Treasury Bills and Bond Reverse Repo	8.30	19,464,000	19,464,000	-	-	-	-
Loans to Other Institutions	7.01	2,313,532	331,456	481,804	938,048	562,224	-
Other Assets - Staff Loan	3.77	3,202,868	73,252	74,397	152,314	486,686	2,416,219
- Other	8.19	1,493,045	72,094	-	124,017	1,296,934	-
<b>Total Interest Sensitive Local Currency Financial Assets</b>		<b>190,895,010</b>	<b>163,267,497</b>	<b>21,651,071</b>	<b>1,214,379</b>	<b>2,345,844</b>	<b>2,416,219</b>
<b>Non Interest Sensitive Local Currency Assets</b>							
Loans to Government		94,743,013	94,743,013	-	-	-	-
Receivables		2,924,028	2,923,630	-	-	-	398
Investment in Equity Securities - Available for Sale		41,211	-	-	-	-	41,211
<b>Total Non Interest Sensitive Local Currency Assets</b>		<b>97,708,252</b>	<b>97,666,643</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>41,609</b>
<b>Total Local Currency Assets</b>		<b>288,603,262</b>	<b>260,934,140</b>	<b>21,651,071</b>	<b>1,214,379</b>	<b>2,345,844</b>	<b>2,457,828</b>
<b>Interest Sensitive Local Currency Financial Liabilities</b>							
Securities sold under agreement to repurchase	7.03	14,089,000	14,089,000	-	-	-	-
<b>Total Interest Sensitive Local Currency Financial Liabilities</b>		<b>14,089,000</b>	<b>14,089,000</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Non Interest Sensitive Local Currency Liabilities</b>							
Balances with Banks and Financial Institutions		146,269,185	146,269,185	-	-	-	-
Balances with Government and Government Entities		1,799,030	1,799,030	-	-	-	-
Balances with Employee Benefit Plans		904,478	904,478	-	-	-	-
Other Payables		28,041,215	28,041,215	-	-	-	-
<b>Total Non Interest Sensitive Local Currency Financial Liabilities</b>		<b>177,013,908</b>	<b>177,013,908</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Total Local Currency Financial Liabilities</b>		<b>191,102,908</b>	<b>191,102,908</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Local Currency Interest Rate Sensitivity Gap</b>		<b>176,806,010</b>	<b>149,178,497</b>	<b>21,651,071</b>	<b>1,214,379</b>	<b>2,345,844</b>	<b>2,416,219</b>

### 40.3 Foreign Currency Risk

Foreign currency activities result mainly from the Bank's holding of foreign currency assets under its foreign reserves management function. Volatility of the foreign exchange markets may expose the Bank to exchange risk. The Monetary Board and Foreign Reserves Management Committee (FRMC) have set percentage holdings of

different currencies in its International Reserves. In deciding on the currency allocation, public debt repayment requirements are given due consideration. Accordingly, the Bank holds most major currencies such as US Dollars, Sterling Pounds, Japanese Yen, Euro, Australian Dollars, and New Zealand Dollars. Compliance with limits established for foreign currency positions are monitored.

#### (b) Net Exposure to foreign currencies

As at 31 December 2012, the Central Bank of Sri Lanka's net exposure to major currencies was as follows.

As at 31 December 2012	Currency							Total All Currencies Rs. 000
	United States Dollars Rs. 000	Euro Rs. 000	Japanese Yen Rs. 000	Sterling Pound Rs. 000	SDR Rs. 000	AUD Rs. 000	Other Currencies	
<b>Foreign Currency Financial Assets</b>								
Cash & Cash Equivalents	114,524,648	7,020,467	68,061,818	3,294,152	-	40,866,045	1,511,003	235,278,133
Derivative Financial Instruments	1,605,296	-	-	-	-	-	2,384,405	3,989,701
Securities at Fair Value through Profit and Loss and Available for Sale Investments	242,692,634	69,668,432	33,212,068	125,259,746	-	70,515,587	14,725,827	556,074,294
IMF Related Assets	-	-	-	-	81,352,282	-	-	81,352,282
Other Foreign Receivables	2,529,308	3,613,310	-	2,100,294	600	-	-	8,243,512
<b>Total Foreign Currency Financial Assets</b>	<b>361,351,886</b>	<b>80,302,209</b>	<b>101,273,886</b>	<b>130,654,192</b>	<b>81,352,882</b>	<b>111,381,632</b>	<b>18,621,235</b>	<b>884,937,922</b>
Proportion	41%	9%	11%	15%	9%	13%	2%	100%
<b>Foreign Currency Financial Liabilities</b>								
Amount Payable to Banks and Financial Institutions	958,779	172,754	1,485,866	2,093	-	355	-	2,619,847
Derivative Financial Instruments	43,937	-	-	-	-	6,182	3,207,000	3,257,119
Amount Payable to Asian Clearing Union	28,943,027	10,928	-	-	-	-	-	28,953,955
IMF Related Liabilities	-	-	-	-	467,642,196	-	-	467,642,196
Other foreign liabilities	64,520,662	-	-	-	-	-	-	64,520,662
<b>Total Foreign Currency Financial Liabilities</b>	<b>94,466,405</b>	<b>183,682</b>	<b>1,485,866</b>	<b>2,093</b>	<b>467,642,196</b>	<b>6,537</b>	<b>3,207,000</b>	<b>566,993,779</b>
Proportion	17%	0%	0%	0%	82%	0%	0%	100%
<b>Net Foreign Currency Exposure</b>	<b>266,885,481</b>	<b>80,118,527</b>	<b>99,788,020</b>	<b>130,652,099</b>	<b>(386,289,314)</b>	<b>111,375,095</b>	<b>15,414,235</b>	<b>317,944,143</b>

Cash & Cash Equivalents include the foreign transactions entered into for buying and selling of various currencies which the trade dates have been occurred in the current financial year and value dates to be fallen in the next financial year. Those transactions were as follows,

As at 31 December 2012	Sri Lanka Rupees Rs. 000	United States Dollars Rs. 000	Euro Rs. 000	Sterling Pound Rs. 000	Japanese Yen Rs. 000	AUD Rs. 000	NZD Rs. 000
	Purchases	209,694,909	14,188,614	-	2,060,425	1,267,999	16,313,617
Sales	(4,333,349)	(214,670,483)	-	(14,407,127)	-	(10,114,605)	-
<b>As at 31 December 2011</b>							
Purchases	61,698,702	65,593,042	294,495	165,858,129	-	95,747,992	43,760
Sales	(14,034,752)	(312,308,476)	(1,032,661)	(30,377,033)	-	(31,439,410)	(43,789)

**40.3 Foreign Currency Risk (Continued)**

As at 31 December 2011, the Central Bank of Sri Lanka's net exposure to major currencies was as follows.

As at 31 December 2011	Currency							Total All Currencies Rs. 000
	United States Dollars Rs. 000	Euro Rs. 000	Japanese Yen Rs. 000	Sterling Pound Rs. 000	SDR Rs. 000	AUD Rs. 000	Other Currencies Rs. 000	
<b>Foreign Currency Financial Assets</b>								
Cash & Cash Equivalents	173,198,199	82,117,739	36,671,577	7,501,573	-	2,424,999	1,637,615	303,551,702
Derivative Financial Instruments	73,132	-	-	290,393	-	2,430,809	-	2,794,334
Securities at Fair Value through Profit and Loss and Available for Sale Investments	118,675,872	57,067,777	16,560,479	116,446,314	-	56,614,482	11,306,238	376,671,162
IMF Related Assets	-	-	-	-	73,090,517	-	-	73,090,517
Other Foreign Receivables	543,014	9,171,689	-	7,318,099	2,435	2,326,594	-	19,361,831
<b>Total Foreign Currency Financial Assets</b>	<b>292,490,217</b>	<b>148,357,205</b>	<b>53,232,056</b>	<b>131,556,379</b>	<b>73,092,952</b>	<b>63,796,884</b>	<b>12,943,853</b>	<b>775,469,546</b>
Proportion	38%	19%	7%	17%	9%	8%	2%	100%
<b>Foreign Currency Financial Liabilities</b>								
Amount Payable to Banks and Financial Institutions	138,621	-	-	-	411,840	387,251	-	937,712
Derivative Financial Instruments	212,575	-	-	374,384	-	454,638	-	1,041,597
Amount Payable to Asian Clearing Union	90,133,003	(100,918)	-	-	-	-	-	90,032,085
IMF Related Liabilities	-	-	-	-	328,772,419	-	-	328,772,419
Other Foreign Liabilities	58,621,764	-	-	-	-	-	-	58,621,764
<b>Total Foreign Currency Financial Liabilities</b>	<b>149,105,963</b>	<b>(100,918)</b>	<b>-</b>	<b>374,384</b>	<b>329,184,259</b>	<b>841,889</b>	<b>-</b>	<b>479,405,577</b>
Proportion	31%	0%	0%	0%	69%	0%	-	100%
<b>Net Foreign Currency Exposure</b>	<b>143,384,254</b>	<b>148,458,123</b>	<b>53,232,056</b>	<b>131,181,995</b>	<b>(256,091,307)</b>	<b>62,954,995</b>	<b>12,943,853</b>	<b>296,063,969</b>

**40.4 Liquidity risk**

Liquidity risk is the difficulty that an entity will encounter in raising funds at short notice to meet commitments associated with financial instruments. Liquidity risk is also the risk that an entity will have to sell a financial asset quickly at much less than its fair value.

(a) Liquidity is a key consideration in determining the composition of the Bank's foreign currency assets. This reflects the potential requirement to liquidate foreign reserves for intervention purposes and to settle other commitments such as public debt and IMF Loan repayments when the need arises. The Bank has adopted the following measures aimed at ensuring quick access to funds:

- Liquid asset ratios based on the liquidity characteristics of securities held
- Limits on maximum proportion of reserves that may be held in one currency and with one counterparty

b) In order to reduce the level of liquidity risk arising out of the local currency activities, particularly open market operations, the Bank uses highly liquid marketable instruments such as Treasury Bills & Treasury Bonds as collateral. It manages the daily liquidity position of the banking system by way of infusing into or withdrawal from the system, using instruments such as repo / reverse repo, CBSL securities & USD /LKR Swaps.

#### 41. PENSION AND OTHER POST EMPLOYMENT BENEFIT PLANS

The Bank operates five defined benefit plans which cover all eligible employees. Under the Employees' Retirement Pension Scheme, employees who joined the Bank prior to 1 January 1998 and complete 10 years of service become eligible. The Pension Scheme is a non-contributory pension scheme where the cost of benefits is wholly borne by the Bank. The Widows' and Orphans' Pension Scheme for male employees and Widowers' and Orphans' Pension Scheme for female employees are open to employees of the Bank who had joined prior to 1 January 1998. Employees eligible under these plans contribute 5% of the monthly basic salary, who were recruited before 1 August 1994 & 10% of monthly basic salary who were recruited on or after 01 August 1994.

The Bank also provides gratuity benefits to employees who have completed five years of service in the Bank and who are not eligible for a monthly pension payment under the Employees' Retirement Pension Scheme. In order to meet this liability, a provision is carried forward in the Balance Sheet, equivalent to the liability calculated using the actuarial valuation.

The Bank has a Post Employment Medical Benefit Scheme which provides reimbursement of certain medical expenses incurred by retired employees on account of themselves or their spouses and by widows/widowers.

The Bank employed an Independent Actuary M/S K. A. Pandit, Consultant & Actuary (Bombay) to re-assess the defined benefit obligations and the current service costs attributable to the Employees' Retirement Pension Scheme Widows' and Orphans' Pension Scheme, Widowers' and Orphans' Pension Scheme, Gratuity Scheme and Medical Benefit Scheme during the year.

Funds of the Employee Retirement Pension Scheme, Widows' and Orphans' Pension Scheme, Widowers' and Orphans' Pension Scheme funds are managed separately and separate books are maintained. However Gratuity Scheme & Medical Benefit Scheme are not separated from the books of accounts of the bank. Further investments and investment income are recorded separately for these funds in the bank books and the income earned from the investments are transferred back to these funds and reinvested with out being distributed.

The following table summarises the components of net benefit expense charged to the income statement, by the Bank in respect of current service cost, interest cost, net of expected return on plan assets, actuarial gain/(losses) & transitional adjustments and the defined benefit obligations as per the actuarial valuation for respective plans.

The total fair value of plan assets of Rs.26,122.416 Mn (2011 – Rs.26,558.264 Mn) fall short the total present value of all benefit obligations of Rs.29,955.104 Mn (2011 – Rs.25,537.339 Mn) at the end of the reporting period resulting in a deficit of Rs. 3,832.688 Mn (2011 – Rs. 1,020.925 Mn).

#### 2012

Benefit Liability/(Asset)	Employee Retirement Pension Scheme Rs. 000	Widows' and Orphans' Pension Scheme Rs. 000	Widowers' and Orphans' Pension Scheme Rs. 000	Gratuity Scheme Rs. 000	Medical Benefit Scheme Rs. 000	Total 2012 Rs. 000
Present Value of Benefit Obligation	24,211,571	3,447,863	564,331	145,702	1,585,637	29,955,104
Fair Value of Plan Assets	(19,635,505)	(4,098,299)	(1,210,344)	(75,478)	(1,102,790)	(26,122,416)
Unrecognised net Actuarial Gains /(Losses)	(4,241,293)	(276,140)	315,438	(31,489)	(563,583)	(4,797,067)
<b>Benefit Liability/ (Asset) non-current</b>	<b>334,773</b>	<b>(926,576)</b>	<b>(330,575)</b>	<b>38,735</b>	<b>(80,736)</b>	<b>(964,379)</b>

Movement in the Benefit Liability /(Asset)	Employee Retirement Pension Scheme Rs. 000	Widows' and Orphans' Pension Scheme Rs. 000	Widowers' and Orphans' Pension Scheme Rs. 000	Gratuity Scheme Rs. 000	Medical Benefit Scheme Rs. 000	Total 2012 Rs. 000
At 1 January 2012	399,341	(945,468)	(353,382)	33,387	(125,449)	(991,571)
Benefit Expense	334,040	(351,091)	(149,425)	19,710	43,448	(103,318)
Contribution Paid	(398,608)	369,983	172,232	(14,362)	1,265	130,510
<b>At 31 December 2012 - non-current</b>	<b>334,773</b>	<b>(926,576)</b>	<b>(330,575)</b>	<b>38,735</b>	<b>(80,736)</b>	<b>(964,379)</b>

<b>41.1 Pension and Other Post Employment Benefit Plans (Continued;)</b>						
<b>Benefit Expense</b>	<b>Employee Retirement Pension Scheme Rs. 000</b>	<b>Widows' and Orphans' Pension Scheme Rs. 000</b>	<b>Widowers' and Orphans' Pension Scheme Rs. 000</b>	<b>Gratuity Scheme Rs. 000</b>	<b>Medical Benefit Scheme Rs. 000</b>	<b>Total 2012 Rs. 000</b>
Interest Cost on Benefit Obligation	2,091,187	270,843	54,707	8,966	128,031	2,553,734
Expected Return on Plan Assets	(1,928,167)	(472,434)	(132,076)	(5,442)	(117,709)	(2,655,828)
Net Actuarial (Gain) /Loss recognized during the year	-	(149,500)	(72,056)	-	14,377	(207,179)
Net Current Service Cost	171,020	-	-	16,186	18,749	205,955
<b>Net Benefit Expense</b>	<b>334,040</b>	<b>(351,091)</b>	<b>(149,425)</b>	<b>19,710</b>	<b>43,448</b>	<b>(103,318)</b>
<b>Actual Return on Plan Assets</b>	<b>1,112,722</b>	<b>(46,328)</b>	<b>75,266</b>	<b>6,699</b>	<b>54,208</b>	<b>1,202,567</b>
<b>Changes in Fair Value of Plan Assets</b>	<b>Employee Retirement Pension Scheme Rs. 000</b>	<b>Widows' and Orphans' Pension Scheme Rs. 000</b>	<b>Widowers' and Orphans' Pension Scheme Rs. 000</b>	<b>Gratuity Scheme Rs. 000</b>	<b>Medical Benefit Scheme Rs. 000</b>	<b>Total 2012 Rs. 000</b>
Fair Value of Plan Assets at the beginning of the year	19,281,669	4,724,335	1,320,757	54,417	1,177,086	26,558,264
Actual Return on Plan Assets	1,112,722	(46,328)	75,266	6,699	54,208	1,202,567
Contribution Received	398,608	(369,983)	(172,232)	14,362	(1,265)	(130,510)
Benefits Paid	(1,157,494)	(209,725)	(13,447)	-	(127,239)	(1,507,905)
<b>Fair value of Plan Assets at the end of the year</b>	<b>19,635,505</b>	<b>4,098,299</b>	<b>1,210,344</b>	<b>75,478</b>	<b>1,102,790</b>	<b>26,122,416</b>
<b>2011</b>	<b>Employee Retirement Pension Scheme Rs. 000</b>	<b>Widows' and Orphans' Pension Scheme Rs. 000</b>	<b>Widowers' and Orphans' Pension Scheme Rs. 000</b>	<b>Gratuity Scheme Rs. 000</b>	<b>Medical Benefit Scheme Rs. 000</b>	<b>Total 2011 Rs. 000</b>
<b>Benefit Liability/(Asset)</b>						
Present Value of Benefit Obligation	20,911,869	2,708,432	547,074	89,655	1,280,309	25,537,339
Fair Value of Plan Assets	(19,281,669)	(4,724,335)	(1,320,757)	(54,417)	(1,177,086)	(26,558,264)
Unrecognised net Actuarial Gains /(Losses)	(1,230,859)	1,070,435	420,301	(1,851)	(228,672)	29,354
<b>Benefit Liability/ (Asset) non-current</b>	<b>399,341</b>	<b>(945,468)</b>	<b>(353,382)</b>	<b>33,387</b>	<b>(125,449)</b>	<b>(991,571)</b>
<b>Movement in the Benefit Liability/(Asset)</b>	<b>Employee Retirement Pension Scheme Rs. 000</b>	<b>Widows' and Orphans' Pension Scheme Rs. 000</b>	<b>Widowers' and Orphans' Pension Scheme Rs. 000</b>	<b>Gratuity Scheme Rs. 000</b>	<b>Medical Benefit Scheme Rs. 000</b>	<b>Total 2011 Rs. 000</b>
At 1 January 2011	483,248	(905,324)	(342,465)	19,025	(124,184)	(869,700)
Benefit Expense	240,264	(393,534)	(182,291)	14,362	(1,265)	(322,464)
Contribution Paid	(324,171)	353,390	171,374	-	-	200,593
<b>At 31 December 2011 - non-current</b>	<b>399,341</b>	<b>(945,468)</b>	<b>(353,382)</b>	<b>33,387</b>	<b>(125,449)</b>	<b>(991,571)</b>



**41.1 Pension and Other Post Employment Benefit Plans (Continued;)**

<b>Benefit Expense</b>	<b>Employee Retirement Pension Scheme Rs. 000</b>	<b>Widows' and Orphans' Pension Scheme Rs. 000</b>	<b>Widowers' and Orphans' Pension Scheme Rs. 000</b>	<b>Gratuity Scheme Rs. 000</b>	<b>Medical Benefit Scheme Rs. 000</b>	<b>Total 2011 Rs. 000</b>
Interest Cost on Benefit Obligation	1,953,600	266,551	50,057	6,178	103,147	2,379,533
Expected Return on Plan Assets	(1,850,152)	(479,339)	(144,437)	(5,133)	(122,160)	(2,601,221)
Net Actuarial (Gain) /Loss recognized during the year	-	(180,746)	(87,911)	(171)	-	(268,828)
Transitional Adjustment	-	-	-	-	-	-
Net Current Service Cost	136,816	-	-	13,488	17,748	168,052
<b>Net Benefit Expense</b>	<b>240,264</b>	<b>(393,534)</b>	<b>(182,291)</b>	<b>14,362</b>	<b>(1,265)</b>	<b>(322,464)</b>
<b>Actual Return on Plan Assets</b>	<b>1,371,971</b>	<b>468,378</b>	<b>60,634</b>	<b>8,154</b>	<b>56,087</b>	<b>1,965,224</b>
<b>Changes in Fair Value of Plan Assets</b>	<b>Employee Retirement Pension Scheme Rs. 000</b>	<b>Widows' and Orphans' Pension Scheme Rs. 000</b>	<b>Widowers' and Orphans' Pension Scheme Rs. 000</b>	<b>Gratuity Scheme Rs. 000</b>	<b>Medical Benefit Scheme Rs. 000</b>	<b>Total 2011 Rs. 000</b>
Fair Value of Plan Assets at the beginning of the year	18,501,515	4,793,392	1,444,366	51,325	1,221,598	26,012,196
Actual Return on Plan Assets	1,371,971	468,378	60,634	8,154	56,087	1,965,224
Contribution Received	324,171	(353,390)	(171,374)	-	-	(200,593)
Benefits Paid	(915,988)	(184,045)	(12,869)	(5,062)	(100,599)	(1,218,563)
<b>Fair value of Plan Assets at the end of the year</b>	<b>19,281,669</b>	<b>4,724,335</b>	<b>1,320,757</b>	<b>54,417</b>	<b>1,177,086</b>	<b>26,558,264</b>

The principal assumptions used in determining employee benefit obligations for all the plans are shown below:

	<b>2012</b>	<b>2011</b>
Discount Rate	<b>10.00%</b>	10.00%
Expected Rate of Return on Assets	<b>10.00%</b>	10.00%
Future Salary Increases	<b>8.50%</b>	8.50%
Future Pension Increases	<b>7.50%</b>	7.50%
Average Remaining years of Service		
CBSL Pension	<b>2 Years</b>	2 Years
W & OP Pension scheme	<b>4 Years</b>	4 Years
WR & OP Pension scheme	<b>4 Years</b>	5 Years
Gratuity scheme	<b>14 Years</b>	14 Years
CBSL Medical Benefit scheme	<b>7 Years</b>	8 Years
Retirement Age	<b>60 years</b>	60 years

**42. FINANCIAL INSTRUMENTS****(a) Fair Value of Financial Instruments**

The fair value of financial instruments is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arms-length transaction. When a financial instrument is traded in an organised and liquid market that is able to absorb a significant transaction without moving the price against the trader, quoted market values represent the fair value.

The bank uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique :

Level 1: Quoted (unadjusted) prices in active markets for identical assets or liabilities;

Level 2 : Other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly;

Level 3 : Techniques which use inputs which have a significant effect on the recorded fair value that value that are not based on observable market data;

The following table shows an analysis of financial instruments recorded at fair value hierarchy:

31 December 2012	Level 1 Rs. 000	Level 2 Rs. 000	Level 3 Rs. 000	Total Rs. 000
<b>Financial Assets</b>				
Derivatives	-	3,989,701	-	3,989,701
Securities at Fair Value through Profit or Loss	169,312,604	-	-	169,312,604
Available for Sale Investments	386,761,690	-	-	386,761,690
	<u>556,074,294</u>	<u>3,989,701</u>	<u>-</u>	<u>560,063,995</u>
<b>Financial Liabilities</b>				
Derivatives	-	3,257,119	-	3,257,119
	<u>-</u>	<u>3,257,119</u>	<u>-</u>	<u>3,257,119</u>
<b>31 December 2011</b>	<b>Level 1 Rs. 000</b>	<b>Level 2 Rs. 000</b>	<b>Level 3 Rs. 000</b>	<b>Total Rs. 000</b>
<b>Financial Assets</b>				
Derivatives	-	2,794,334	-	2,794,334
Securities at Fair Value through Profit or Loss	106,006,362	-	-	106,006,362
Available for Sale Investments	270,664,801	-	-	270,664,801
	<u>376,671,163</u>	<u>2,794,334</u>	<u>-</u>	<u>379,465,497</u>
<b>Financial Liabilities</b>				
Derivatives	-	1,041,597	-	1,041,597
	<u>-</u>	<u>1,041,597</u>	<u>-</u>	<u>1,041,597</u>
<b>Repurchase and Reverse-Repurchase Agreements</b>	<b>Currency in Circulation</b>			
The reported value of repurchase and reverse-repurchase agreements is considered to approximate their fair value due to the short term nature of the agreements. The carrying value of Sri Lanka Government Securities sold under agreements to repurchase as at 31 December 2012 was Rs. 7,015 Mn (2011 – Rs 14,089 Mn) and there were no CBSL Securities sold under agreements to repurchase (2011 - Rs. Nil Mn). The carrying value of Sri Lanka Government Securities Purchase under agreements to resold as at 31 December 2012 was Rs. 26,579 Mn (2011 – Rs 19,464 Mn)	The fair value of Currency in Circulation is considered to be its face value as reported in the Financial Statements.			
	<b>Deposits</b>			
	The carrying values of deposits are considered to approximate their fair value as they are payable on demand.			
<b>(b) Determination of Fair Value and Fair Value Hierarchy</b>	Set out below is a comparison, by class, of the carrying amounts and fair values of the Bank's financial assets and liabilities.			
<b>Fair values</b>	<b>Carrying Amount</b>		<b>Fair Value</b>	
	2012	2011	2012	2011
	Rs '000	Rs '000	Rs '000	Rs '000
<b>Foreign Currency Financial Assets</b>				
Cash & Cash Equivalents	235,278,133	303,551,702	235,278,133	303,551,702
Derivative Financial Instruments	3,989,701	2,794,334	3,989,701	2,794,334
Foreign Currency Trading/ Available for Sale Securities	556,074,294	376,671,162	556,074,294	376,671,162
IMF Related Assets	81,352,282	73,090,517	81,352,282	73,090,517
Other Foreign Receivables	8,243,512	19,361,831	8,243,512	19,361,831
<b>Total Foreign Currency Financial Assets</b>	<u>884,937,922</u>	<u>775,469,546</u>	<u>884,937,922</u>	<u>775,469,546</u>
<b>Local Currency Financial Assets</b>				
Sri Lanka Government Securities	175,251,772	183,885,564	175,251,772	183,885,564
Loans to Government	111,291,843	94,743,013	111,291,843	94,743,013
Loans to Other Institutes	1,844,237	2,313,533	1,844,237	2,313,533
Other Local Receivables	2,970,099	2,924,028	2,970,099	2,924,028
Investment in Financial and Other Institutions	41,095	41,211	41,095	41,211
Other Assets	5,578,483	4,695,913	5,578,483	4,695,913
<b>Total Local Currency Financial Assets</b>	<u>296,977,529</u>	<u>288,603,262</u>	<u>296,977,529</u>	<u>288,603,262</u>
<b>Total Financial Assets</b>	<u>1,181,915,451</u>	<u>1,064,072,808</u>	<u>1,181,915,451</u>	<u>1,064,072,808</u>
<b>Foreign Currency Non-Financial Assets</b>				
Allocated Gold	77,688,838	43,819,156	77,688,838	43,819,156
<b>Total Foreign Currency Non-Financial Assets</b>	<u>77,688,838</u>	<u>43,819,156</u>	<u>77,688,838</u>	<u>43,819,156</u>

<b>Foreign Currency Financial Liabilities</b>				
Amounts payable to Banks & Financial Institution	2,619,847	937,712	2,619,847	937,712
Derivative Financial Instruments	3,257,119	1,041,597	3,257,119	1,041,597
IMF related Liabilities	467,642,196	328,772,419	467,642,196	328,772,419
Amounts payable to ACU	28,953,955	90,032,085	28,953,955	90,032,085
Other Foreign Payables	64,520,662	58,621,764	64,520,662	58,621,764
<b>Total Foreign Currency Financial Liabilities</b>	<b>566,993,779</b>	<b>479,405,577</b>	<b>566,993,779</b>	<b>479,405,577</b>
<b>Local Currency Financial Liabilities</b>				
Commercial Banks & Other Financial Institutions	166,288,378	146,269,185	166,288,378	146,269,185
Balances with Government and Government Entities	699,628	1,799,030	699,628	1,799,030
Securities Sold under Agreement to Repurchase	7,015,000	14,089,000	7,015,000	14,089,000
Balances with Employee Benefits Plan	1,548,447	904,478	1,548,447	904,478
Other Payables	31,939,398	28,041,215	31,939,398	28,041,215
<b>Total Local Currency Financial Liabilities</b>	<b>207,490,851</b>	<b>191,102,908</b>	<b>207,490,851</b>	<b>191,102,908</b>
<b>Total Financial Liabilities</b>	<b>774,484,630</b>	<b>670,508,485</b>	<b>774,484,630</b>	<b>670,508,485</b>
<b>43. COMPARATIVE INFORMATION</b>				
	2011			
As reported previously:	Rs. 000			
<b>Foreign Currency Financial Assets</b>				
Cash & Cash equivalents	303,538,372			
Other Foreign Receivables	19,375,161			
<b>Current Presentation:</b>	2012	2011		
	Rs. 000	Rs. 000		
<b>Foreign Currency Financial Assets</b>				
Cash & Cash equivalents	235,278,133	303,551,702		
Other Foreign Receivables	8,243,512	19,361,831		
<b>Reasons for change in the presentation and classification:</b>				
Above classifications were made in the financial statements of the Bank for better presentation.				
<b>Nature of the Transaction</b>				
	2012		2011	
	Rs 000		Rs 000	
<b>Transactions:</b>				
Sri Lanka Government Securities Held by CBSL, (a)	148,672,772		164,421,564	
Outright sales of Government Securities	260,000		-	
CBSL and Government Securities Purchased / Sold under Agreement to Repurchase / Sales	1,550,252,513		7,792,273,174	
Cost of Printing currency notes, for the Year ended 31 December 2012 (d)	1,205,091		1,222,901	
Guarantees provided by CBSL, as at 31 December (Note 45.2)	2,306,711		2,152,831	
Payments for Goods, Services and Taxes, during the Year ended 31 December 2012 (e)	1,167,992		400,057	
Paid Surplus to Government, during the year (Note 28)	33,000,000		22,000,000	
Advances to Government, (Note 8)	111,291,843		94,743,013	
Government Securities held for specific purposes	1,201,292		1,232,281	
Gross Foreign Exchange Transactions during the year, (g)				
Sales	209,530,618		347,065,137	
Purchases	32,975,250		30,734,653	
SWAP	110,783,700		11,593,125	
Refinance (i)	5,452,617		4,506,581	
Loans given under Sushana phase 1 & 2 & Provincial develop. Credit scheme	1,711,019		2,052,734	
External legal expenses (k) (Note 33)	-		324,371	
Funds Received in respect of Abandoned Property, during the year	136,500		-	
Dividend Income received from Lanka Clear & CRIB	14,267		11,851	
Payments made to Lanka Clear (Pvt) Ltd.	667		613	
<b>Balances:</b>				
RTGS Balances with Banks & Financial Institutions	84,679,924		75,130,539	
Nostro Balance with BOC London	72,320		34,385	
Receivable from Treasury and other Ministries	2,403,335		2,399,849	
Receivable from Ceylon Petroleum Corporation (k)	480,814		480,814	
Payable to Ministry of Finance & Planning (Note 18)	43,324,799		53,359,431	
Current Account Balances with Government & Government Entities As at 31 December 2012	393,691		1,643,525	
Investment in Lanka Clear	29,500		29,500	
Investment in CRIB	5,844		5,961	
Other Transactions & Balances (l)	1,142,497		937,270	

a) The Domestic Operations Department performs its direct functions of implementing the Bank's monetary policy mainly through open market operations as per the sections 90-92 of Monetary Law Act No 58 of 1949 as amended (MLA) and enforcing Statutory Reserve Requirement as per the sections 93-98 of MLA and functions as the banker to both commercial banks where government has shareholdings and certain other financial institutions and governmental entities. The aggregate balances arising from this function as at 31 December 2012 are given in Note 19 and 20. Interest earned on the government securities is given in Note 29.

b) Empowered by the sections 28-33 of the MLA the Bank Supervision Department of CBSL carries out the regulatory and supervisory functions of the banks licensed by the Monetary Board of Central Bank. As at 31 December 2012, 08 licensed commercial banks & licensed specialised banks which had been funded by the government or has a significant influence, came under the supervision of the department.

The Department of Supervision of Non-bank Financial Institutions of CBSL carries out its regulatory and supervisory functions in respect of Non-bank Financial Institutions. Accordingly, related entities of State controlled or funded banks, Non-bank Financial Institutions are under supervision.

c) As per the Section 113 of MLA, the Monetary Board and the CBSL are vested with the function of public debt management. Accordingly, as the agent of the government, the Public Debt Department (PDD) issues securities to the domestic market to meet the budgetary requirements and services both foreign and domestic debt. The PDD deals with public debt management and debt market development. It manages the government debt to ensure that financing needs of the government and its payment obligations are met.

d) The Bank has the sole right and authority to issue currency in Sri Lanka as per section 49 of the MLA. Accordingly, the Currency Department of CBSL functions as the sole issuing authority of the legal tender in Sri Lanka. Printing of the currency notes is carried out by De La Rue Lanka Currency and Security Print (Pvt) Ltd., of which 40% shareholding is owned by the Government.

e) In carrying out the normal operations, the Bank enters into transactions to obtain various goods and services with government entities or entities in which government has significant influence or control.

f) The Bank commonly acts as trustees and in other fiduciary capacities that result in the holding or placing of assets and liabilities on behalf of government, trusts, retirement benefit plans and other institutions, as explained in Note 46.

g) International Operations Department of the Bank monitors the development in the domestic foreign exchange market and overnight net foreign exchange open positions of commercial banks. In monitoring the domestic foreign exchange market developments, the Bank is on both sides of the market to moderate the excessive volatility in the exchange rate of Sri Lanka Rupee. The amounts of purchases and sales of foreign exchange represents results of such monitoring activities.

h) The Bank also had custodial arrangements with one State-controlled bank, for which no charges were levied.

i) The Bank provides refinance loans and for which credit guarantees also provided as described in note 45.2 of which CBSL funded projects amounted to Rs. 5,452.617 Mn (2011 Rs 4,506.581 Mn) and government funded projects amounted to Rs. 2,879.460 Mn (2011 - Rs. 2,974.412 Mn)

j) As per the circular issued by Director Bank Supervision, the banks who do not maintain the minimum advance limit of 10% to agriculture, contribute the shortfall to refinance fund operated by RDD of the bank. During the year RDD has generated Rs. 742.839 Mn loans under the refinance scheme to Peoples Bank (367.835 Mn), Bank of Ceylon (72.700 Mn) Pradeshiya Sanwardana Bank (265.640 Mn) and Lankaputhra Development Bank (36.664 Mn) & for which RDD has received an interest of Rs. 29.728 Mn.

k) Upon the request made by the Hon. Attorney General, CBSL made legal fees to foreign lawyers who appeared on behalf of Ceylon Petroleum Corporation (CPC). These payments amounting to Rs. 480.814 Mn (2011 - Rs. 480.814 Mn) considered as receivable from CPC.

Further during the year CBSL has paid Rs. 27.674 Mn as legal fees for foreign lawyers who appeared in the arbitration proceedings on hedging case initiated by Deutsche Bank AG against Democratic Socialist Republic of Sri Lanka. (Note 33)

l) Other Transactions & Balances includes the transactions and balances carried out with individual government & government departments, state control activities that are not individually significant. The nature of the transactions are Guarantees provided by CBSL of Rs. 178.548 Mn (2011- 120.607 Mn), funds collected in respect of exchange control activities Rs. 14.172 Mn (2011- Rs.25.031 Mn), government securities held for specific purpose Rs. 76.235 Mn (2011- Rs. 69.535 Mn), RTGS balance of NSB Fund Management amounting to Rs 0.242 Mn (2011-0.117 Mn), Loans given under Susahana phase 1 & 2 & provincial development credit loan scheme Rs 77.468 Mn (2011- 120.481 Mn) , Payments for Goods, Services and Taxes, during the year ended 31 December 2012 Rs. 249.309 Mn (2011- Rs. 334.437 Mn) current account balances of government & government entities of Rs. 305.937 Mn (2011-Rs. 155.505 Mn), funds received in respect of Abandoned Property Rs. 55.805 Mn (2011 - Rs. 74.076 Mn) and External Legal Expenses Rs. 27.674 Mn.

During the year 2011, bank has acquired a property in New York and it was rent out to the Ministry of External Affairs for a three year period commencing 01 st June 2012 at a monthly rental of USD 68,000. A sum of Rs. 43.235 Mn has been accrued as the rent receivable to the bank for 5 months period and included in Sundry Assets.

The Sundry Assets include Rs.88 Mn, which is receivable from UDA. This amount represents the lease hold property at Transwork Square - Colombo 01, which was used as the CBSL Car Park. This has been acquired by the

lessor (UDA), before the expiration of the lease period and the Rs.88 Mn from the initial payment, applicable for the remaining lease period, has been recorded as a receivable from UDA.

The Monetary Board of CBSL has entered into a Memorandum of Understanding (MOU) with Wild Life Conservation Department on 20th Nov 2008, to collaborate with each other for the construction, establishment & maintenance of the Inspection Bungalow & the Wild Life Office at Somawathiya for the benefit of both parties. The cost of the Inspection Bungalow which is used by the bank has been recorded under PPE and depreciated over the MOU period (30 years). Further, as per the article 3 of MOU, CBSL has agreed to hand over the possession of the Wild Life Office to the Wild Life Conservation Department, after construction. The cost of 6.2 Mn, incurred by the CBSL to construct the Wild Life Office has been identified as the right to use the Inspection Bungalow used by the bank and recorded under Sundry Assets & amortized over the period of MOU.

#### 44.2 Transactions with Key Managerial Personnel

Key Managerial Personnel of the Bank are the members of the Monetary Board that includes Governor (MLA restricts such members' positions as director, officer, employee or shareholder of any banking institution.), Deputy Governors, Assistant Governors and Director Management Audit. Particulars of transactions with Key Managerial Personnel were as follows:

##### Compensations to the Key Management Personnel

	2012 Rs 000	2011 Rs 000
Short Term Employee Benefits	58,189	44,012

In addition to above compensation the Bank also provides non cash benefits to Key Management Personnel in terms of employment contracts with them.

#### 44.4 Other Transactions with Key Managerial Personnel

	2012 Rs 000	2011 Rs 000
Loans to Key Management Personnel	45,458	29,835

All the loans are adequately secured and carry interest rates ranging from 2%-12% depending on the loan category and are repayable monthly.

#### 44.5 Transactions with Post Employment Benefit Plans

	2012 Rs 000	2011 Rs 000
Contributions paid and payable	33,805	23,288

The Bank contributed various amounts to Pension and Other Post Retirement Plans as disclosed in Note 41 and paid Rs. 147.174 Mn (2011 – Rs. Nil) to Employees Provident Fund. In the normal course of business the Bank provides banking and financial services to its post employment plans. Amounts of balances with such plans are given in Note 22.

#### 45. Contingent Liabilities and Capital Commitments

##### 45.1 Financial Guarantee Contracts

The Bank acting as an agent of the government or its agencies and institutions, provides guarantees to various parties on the strength of counter guarantees issued to CBSL by the General Treasury. There were no such outstanding guarantees as at 31 December 2012.

##### 45.2 Credit Guarantees

The Regional Development Department (RDD) of the Bank performs the functions of providing refinance out of loan proceeds from external lines of credit to participating financial institutions for financing small and medium enterprises; issuing credit guarantees on loans to such enterprises; collecting guarantee premia, administering credit guarantee funds and undertaking post credit inspection and follow up action to ensure proper utilization of loan funds with a view to preventing defaults. During the year RDD continued to provide refinance facilities under which the Bank provided guarantees against losses arising to a participating credit institution, which grants credit under this arrangement. This is not a guarantee on default by recipient of loans but against loss, which means that participating credit institutions should submit claims only in respect of amounts in loss after having pursued recovery action. The amount of contingent liabilities arising out of this arrangements are given below.

##### Local commercial bank - in respect of credit guarantees.

	Currency of guarantee	Outstanding Guarantee Amount	
		2012 Rs. 000	2011 Rs. 000
Related Parties	Rupees		
- CBSL Funded Projects		318,421	490,556
- GOSL Funded Projects		2,166,839	1,782,882
Others	Rupees		
- CBSL Funded Projects		584,615	410,629
- GOSL Funded Projects		2,997,200	576,177
Total Credit Guarantees		<u>6,067,075</u>	<u>3,260,244</u>

### 45.3 Fiduciary Activities

The Bank carries out fiduciary activities under the provisions of Monetary Law Act. Acting in such capacity results in holding or placing of funds on behalf of various parties. However, the Bank does not expect any liability to arise on account of such activities.

### 45.4 Legal Claims

The Bank is a defendant in 02 cases where legal actions instituted by stakeholders of entities involved, claiming Rs.36 Mn with legal interest. These cases are being contested by the Bank and no provision has been made in the financial statements.

The Bank is a plaintiff in 04 cases claiming Rs 14.495 Mn with legal interest for the damages.

Further, there were a number of legal proceedings outstanding against the Bank as at 31 December 2012 no provision has been made, as the bank is of the opinion that it is unlikely that any significant loss will arise.

### 45.5 Commitments

a) As at 31 December 2012 the Bank has capital commitments amounting to Rs. 710.887 Mn (2011 - Rs. 128.907 Mn and Euro 194,934.60), in respect of the acquisition of Property, Plant and Equipment.

b) As at 31 December 2012 outstanding Forward exchange transactions as follows.

Forward exchange contracts	2012 000	2011 000
Forward exchange sales		
AUD	-	265,000
GBP	35,000	170,000
USD	1,368,000	213,000
Forward exchange purchases		
AUD	-	567,800
GBP	-	766,500
USD	-	25,000
LKR	25,432,160	23,142,000

### 45.6 Assets Pledged

In order to facilitate the securities settlement process, GBP 25 Mn (carrying value GBP 25.434 Mn) worth of securities (2011- AUD 55 Mn -Carrying value -AUD

55.176 Mn) have been pledged by the Bank to the Euro Clear Bank and obtained a credit facility of USD 35 Mn (2011 - USD 35 Mn). The pledged securities are held in a separate account at the Euro Clear.

Those securities are presented in the financial statement of financial position as "Financial Assets Available For Sale". The bank conducts these transactions under the terms that are usually based on the "Collateral Agreement Governing Secured Borrowings by Participants in the Euroclear System" and "General Conditions Governing Extensions of Credit to Participants in the Euroclear System" guidelines.

### 45.7 Contingent Liability against Sovereign Residencies

As per the lease agreement entered between the Monetary Board of the Central Bank of Sri Lanka (CBSL) and S.W.R.D.Bandaranayake National Memorial Foundation to operate Sovereign Residencies, the subsequent investments made by the lessee to the premises should be agreed by both parties and be recorded. In the event the agreement is terminated the CBSL, as the lessor would have to pay an agreed percentage of the value of the investment based on the year of operation. At the end of the 31 December 2012 the contingent liability of the CBSL as the lessor is estimated at Rs.15.352 Mn (2011 - Rs. 17.546 Mn) being the 35% of the investment value considered at the end of Fourth year of operation.

### 46. Trust and Custodial Activities

Bank commonly act as trustees and in other fiduciary capacities that result in the holding or placing of assets and liabilities on behalf of government, trusts, retirement benefit plans and other institutions. The significant trust activities performed by the Bank are as follows:

a) The Bank handles disbursements and repayments of various foreign loans and, grants under foreign funded development projects and credit schemes on behalf of the Government of Sri Lanka (GOSL). It also collects counter party funds under various foreign loans and grants on behalf of GOSL and invests such funds in treasury bills on requests made by donor agencies.

b) Bank is the custodian of the Employees Provident Fund (EPF). In terms of the statute, the functions of the Monetary Board consist of receiving contributions, surcharges, income from investments, maintaining proper accounts of registered members of EPF, investing surplus funds and payment of benefits to the members.

c) Bank administered the Deposit Insurance Scheme, which was a voluntary deposit insurance scheme open to banking institutions licensed by the CBSL and cooperative societies registered under the Cooperative Societies Law No 5 of 1972, which carry on banking business & with effect from 01st October 2010

funds have been transferred to the Sri Lanka Deposit Insurance scheme which was formed as per gazette no:1673/11 -28 September 2010.

- d)** Bank carries out regulatory and supervisory functions in respect of registered finance companies (FCs) and attends to related matters under the authority delegated to it by the Monetary Board. While carrying out such functions, with respect to failed FCs, various actions are taken, including the vesting of assets of persons responsible for the unviable and insolvent condition of such companies, with the Monetary Board as a form of security.
- e)** As per the gazette no:1673/11 dated 28th September 2010, Bank has established a Mandatory deposit insurance scheme filled Sri Lanka Deposit insurance scheme w.e.f 01st October 2010. All Liscenced commercial banks, Liscenced Specialized banks (LSBs) & Registered Finance companies shall be the members of this scheme. The deposits to be insured include; the demand, time & savings, deposit liabilities of the member institutions excluding all borrowing instruments are insured with specific exclusions as per 5.2 of the said gazette notification. The deposit insurance fund has been created with the transfer of Rs.331.653 Mn of the investments of Voluntary Deposit Insurance scheme & Rs.282.337 Mn of investments made out of collections from LCB's as abandoned property. The amount of compensation payable to a depositor shall be limited to Rs.0.2 Mn or its equivalent in the case of foreign currency deposits if such amount exceeds Rs.0.2 Mn. The payment of compensation shall not be a liability of the Monetary Board or the Central Bank of Sri Lanka, & shall be limited to funds available or raised in the Deposit insurance fund including any borrowings permitted & contributions received. The Monetary Board & the Central Bank of Sri Lanka shall not be responsible for any liability that exceeds the total amount lying to the credit of the fund.
- The unit established in the Bank supervision dept, is responsible for operation & management of the scheme and maintain separate books & accounts distinctly separate from the Financial statements of the bank & the Auditor general should be the Auditor.
- f)** As per the circular issued by Director Bank Supervision, the banks who do not maintain the minimum advance limit of 10 % to agriculture are required to, contribute the shortfall to refinance fund operated by Regional Development Department (RDD) of the bank . RDD refinances such amounts collected through Bank of Ceylon, Peoples' bank Pradeshiya Sanwardena Bank and Lankaputhra Development Bank to agriculture under Viskam refinance scheme. The total collections outstanding as at end of the 31 December 2012 amounted to Rs. 641.433 Mn ( 2011- 1,111.574 Mn). As at end of 31 December 2012 RDD has granted Rs. 742.839 Mn loans under the refinance scheme and received an interest of Rs. 29.728 Mn for loans given. RDD holds Rs. 4.117 Mn (2011- 879.5 Mn) of investments in government securities. Further Rs.188.067 Mn (2011- 12.966 Mn) of income earned from the investments.
- g)** A Facility Agreement between China Development Bank Corporation (CDB) and Government of Sri Lanka was signed on 31st March 2011 for USD 500 Million. According to the Facility Agreement, as Escrow Agent, an Escrow Account has been opened in the Central Bank of Sri Lanka for the sole purpose of deposit of the Loans, which account shall be jointly operated by the lender and the borrower pursuant to this Agreement. (Note 18)
- h)** On behalf of the Monetary Board of the Central Bank of Sri Lanka ( CBSL), Regional Development Department ( RDD ) acts as the exclusive agent of the Government of Sri Lanka ( GOSL ) with regard to the projects funded by GOSL and foreign donors. RDD also implements the CBSL funded projects.

Concluded Projects								
Name of the Project	Total Allocation of the Fund (Mn.)		Purpose of the Loan	Refinance Granted to PFIs (Rs. Mn.)	Salient Features	Warranties & Assurance	General Conditions	Special Conditions
Tea Development Project	USD	24.50	To increase tea small holders income and improve the natural environment in the project areas	2,550.90	Collection of recoveries from PFIs as per scheduled date to be transferred to DST.			
Second Perennial Crop Development Project	SDR	11.56	Commercialization of the perennial crop sector, increase production, nursery development post harvest handling, processing and marketing	1,453.11				
Plantation Sector Reform Project	USD	40.00	To support policy and institutional reforms in the plantation sub-sector to increase the productivity and profitability and maintain the competitive advantage of the plantation industry of Sri Lanka.	5,200.00				
Susahana Finance & Leasing Co.	LKR	352.69	To provide credit facilities to the resumption of enterprises affected by Tsunami	351.06				
Small Business Revival Programme	LKR	2,656.00	To provide credit facilities to the resumption of SMEs affected by Tsunami	2,663.40				
Small business Revival Programme – Revolving Fund	LKR	150.00	To provide credit facilities to the resumption of SMEs affected by Tsunami	122.72				
Skill Development Project	LKR	94.31	To improve quality and relevance of skill training programmes to build high quality workforce and address skill mismatching	94.59				
Urban Environment Infrastructure Development Project	USD	4.00	To improve environmental facilities, health and sanitary conditions of the people living in urban and semi – urban areas.	369.15				
Housing Guarantee Low Income Housing Shelter Project	USD	25.00	To assist low income community in the country to build houses, and renovate and expand their residencies.	1,362.00				
Urban Development Low Income Housing Project	SDR	15.10	To provide capital to support low income households for housing improvement	1,915.76				
North Western Province Water Resource Development Project	USD	1.80	To improve economic, social and nutritional well-being of the people living in the project areas	102.76				
Mathale Regional Economic Advancement Project	SDR	2.00	Permanent rising and sustaining of income of small entrepreneurs	249.06				
Mid Country Perennial Crop Development Project	SDR	11.56	To provide credit facilities to the production of perennial crops in the mid country area.	642.00				
Agriculture Rehabilitation Project	SDR	17.05	To rehabilitate persons and property affected by the civil disturbances in the Northern and eastern provinces and five bordering districts.	843.00				
Small Holder Tea Development Project	USD	12.60	To develop small holder tea sector and rehabilitate tea facilities.	645.93				
Poverty Alleviation Micro Finance Project	YEN	1,368.00	Setting up of an effective credit delivery mechanism for channeling formal credit to income generating activities	1,402.45				
Small Farmers Landless Credit Project	USD	17.40	To establish a cost effective and sustainable micro credit delivery system to generate employment and improve saving habits among the low income receiving people	345.69				
Kegalle Integrated Rural Development Project	SDR	1.50	To uplift the standard of living of the people in the project areas by promoting income generating activities	148.00				
Southern Province Rural Development Project	SDR	27.90	To improve the quality of the life of the people in the southern province	564.00				
EIB Contract B	EUR	10.00	Restruction of SMEs directly affected by Tsunami	1,553.27				
Susahana	LKR	3,000.00	To provide credit facilities to resume MSMEs affected by Tsunami.	2,750.00	Collection of recoveries from PFIs as per scheduled date to be transferred to FD.			
Susahana Phase II	LKR	500.00	To providing credit facilities to resume MSMEs affected by the Tsunami	105.54				
Awakening North	LKR	2,000.00	To extend credit to agriculture, livestock, micro and small enterprises in the Northern Province.	2,000.00	Collection of recoveries from PFIs as per scheduled date to be transferred to relevant A/Cs of the RDD.			
Resumption of Economic Activities in the Eastern Province	LKR	1,000.00	Granting loans to SME sectors' activities in the Eastern Province.	1,000.00				



Ongoing Projects								
Name of the Project	Total Allocation of the Fund (Mn.)		Purpose of the Loan	Refinance Granted to PFIs (Rs. Mn.)	Salient Features	Warranties & Assurance	General Conditions	Special Conditions
Second Perennial Crops Development Project – Revolving Fund	LKR	1,200.00	To provide credit facilities to develop the perennial crops sector in the country.	1,198.26		No Warranties and assurances.	Financial Statements should be audited by external auditors.	The rights and obligations of the agreements will not be assigned, amended, abrogated or waived without the agreement of all relevant parties.
Tea Development Project – Revolving Fund	LKR	1,100.00	To provide credit facilities to develop the tea sector in the country.	856.99				
Matale Regional Economic Advancement Project – Revolving Fund	LKR	77.00	To raise the income of rural and farm families and to provide funds for medium scale entrepreneurs to create non-farm enterprises and to expand existing projects as well in the Matale District.	77.00				
Sabaragamuwa Province Integrated Rural Development Project – Revolving Fund	LKR	100.00	To enhance and start new income generating activities in the Sabaragamuwa Province.	100.00				
Construction Sector Development Project	LKR	9.00	To strengthening the financial and technical capacities of private local businesses to effectively participate in construction and public works in post Tsunami reconstruction.	1,399.73				
Small Plantation Entrepreneurship Development Project	SDR	1.75	To enhance the living standard of the low income communities in Moneragala, Kandy, Kegalle and Nuwera Eliya.	82.74				
Poverty Alleviation Micro finance Project II - ( Probadini )	YEN	2,575.00	Enhancement of the living standard of households whose monthly income less than Rs. 15,000/= in project location.	2,678.54				
Sabaragamuwa Province Integrated Rural Development Project Phase II	LKR	70.00	To enhance and start new income generating activities in the Sabaragamuwa Province.	70				
Self Employment Promotion Initiative	LKR	115.90	To provide financial assistance to trained youth who passed out from recognized vocational training institutions in the country for establishment of their own self employment projects.	112.04				
Post Tsunami Coastal Rehabilitation Resource Management Project	SDR	2.09	To assist communities adversely affected by Tsunami disaster to recover their assets and re-establish the foundation of their usual economic activities, while diversifying into new profitable income generating activities.	109.96				
Viskam ( Special Lona Scheme for Agriculture Sector Development)	LKR	1,325.60	To ensure the availability of credit for investment, diversification and improvement of commercial agri – business in the country.	880.00	When the mandatory requirements are fulfilled by contributory banks, funds will be returned.			
Provincial Development Credit Scheme	LKR	2,900.00	To provide credit facilities to medium and long term projects in the SME sector in the country.	2,645.71	Collection of recoveries from PFIs as per scheduled date to be transferred to FD.			
Small Farmers and Landless Credit Project - Revolving Fund	LKR	207.29	To promote the intensification of agricultural production by small farmers and the establishment of small scale non-farming rural enterprises.	776.17	Collection of recoveries from PFIs as per scheduled date to be transferred to relevant A/Cs of the RDD.			
Dry Zone Live hood Support & Partnership Programme	LKR	252.95	To provide facilities to income generating activities in Anuradhapura, Moneragala, Kurunegala and Badulla Districts.	252.92				
Poverty Alleviation Micro finance Project – Revolving Fund	LKR	325.00	Strengthening of economic conditions of low income families	1,794.33				
Saubagya	LKR	4,720.00	To extend credit to MSMEs and disaster affected MSMEs.	4,482.56				
Awakening North – Phase II	LKR	2,154.25	To extend credit to agriculture, livestock, micro and small enterprises in the Northern Provinces.	668.36				
Resumption of Economic Activities in the Eastern Province – Phase II	LKR	1,078.27	To extend credit to agriculture, livestock, micro and small enterprises in the Eastern Province.	528.12				
Repair of Damaged Houses in the North and East	LKR	100.00	To provide credit facilities for repairing the damaged houses that were damaged during the conflict in the Northern and Eastern Provinces.	84.10				
National Agribusiness Development Programme	USD	32.90	To assist smallholders producers and the landless, especially the youth by increasing the income of the beneficiaries in the market/value chain development and providing financing and training for employment to the landless especially the youth to improve their income					

#### 47. EVENTS OCCURRING SUBSEQUENT TO BALANCE SHEET DATE

There were no material events occurring subsequent to balance sheet date that require adjustment or disclosure in the financial statements.

## 2. BANK SUPERVISION

In terms of Section 28 of the Monetary Law Act, the Bank Supervision Department (BSD) has been established for the purpose of continuous supervision and periodic examination of banks in Sri Lanka. The provisions of the Banking Act require licensed commercial banks (LCBs) and licensed specialised banks (LSBs) to obtain the approval of the Monetary Board and the Director of Bank Supervision (DBS) to carry out certain activities/operations such as opening/relocating of banking outlets, setting up subsidiaries, acquiring material interest in commercial banks, amendments to banks' Articles of Association, use of the word 'bank' as part of names by other entities, approving the fitness and propriety of directors, chief executive officers, secretaries and other executive officers. Further, the Monetary Board is empowered to issue prudential directions on the manner in which any aspect of business of banks is to be conducted to ensure the soundness of the banking system. All banks are required to comply with several other prudential regulations imposed by the Monetary Board.

As at the end of 2012, the banking sector in Sri Lanka comprised 24 LCBs and 9 LSBs. The names of these banks are provided in Annex II-I. A summary of the main activities performed by BSD during 2012 is provided below.

### 2.1 Issuance of Prudential Regulations

Details of all prudential regulations issued are provided in Part III of this Report. A summary of the major prudential regulations is given below.

- (a) **Ceiling on rupee credit growth of licensed banks:** In order to restrict the higher than desired credit growth of licensed banks, in March 2012, the rupee credit growth of banks in 2012 was restricted to 18 per cent of the total outstanding rupee credit as at end 2011 or to Rs. 800 mn, whichever is higher. Where the corresponding funds were raised from overseas sources, a higher limit of 23 per cent or Rs. 1,000 mn, whichever is higher, was allowed.
- (b) **Foreign exchange trading activities of licensed commercial banks:** In order to promote a high standard of business conduct and market practice for the orderly conduct of foreign exchange trading activities in Sri Lanka, a Direction was issued covering market practices, ethics, standard of conduct and practices to be followed, the level of knowledge required and sanctions on non-compliance.
- (c) **Expansion of the definition of Liquid Assets:** Government Securities held under Reverse Repo Agreements by licensed banks were determined as liquid assets for the purpose of meeting the Statutory Liquid Assets Ratio.
- (d) **Outsourcing of business operations:** A new Direction was issued covering the activities to be outsourced by banks, including the internal audit and information technology functions.

- (e) **Classification of banking outlets:** With a view to streamline and rationalise the branch approval procedure, licensed banks were required to reclassify existing banking outlets into two categories, namely branches and student savings units. All existing banking outlets except student saving units were to be upgraded as branches with effect from 01 January 2013. Further, the licensed banks were required to conspicuously display the list of activities for the information of the customers in the premises of a branch, when such branch is extending only selected banking services.
- (f) **Recognition of ICRA Lanka Limited as an external credit assessment institution:** ICRA Lanka Limited, a fully owned subsidiary of ICRA Limited of India was recognized as an approved external credit assessment institution for the purposes of all regulatory requirements applicable to licensed banks.
- (g) **Implementation of Pillar II – Supervisory Review Process under Basel II Capital Adequacy Framework:** A consultation paper was issued to strengthen the capital planning and risk management process in licensed banks.
- (h) **Adoption of Sri Lanka Accounting Standards LKAS 32, 39 and SLFRS 7:** Draft Guidelines on the adoption of LKAS 32, 39 and SLFRS 7 and draft formats for the publication of quarterly and annual financial statements were issued.
- (i) **Interest rates on credit cards and housing loans:** Considering the trends in market interest rates, the maximum annual interest rate that licensed banks could charge on housing loans and credit card advances were increased to 16 per cent and 28 per cent, respectively.
- (ii) **Special payments/benefits to directors at their retirement:** In order to ensure good governance, locally incorporated licensed banks were requested to obtain prior approval from their shareholders for any special payments/benefits made to bank directors at their retirement in addition to normal retirement payments/benefits on arm's length basis. Further, banks were requested to incorporate such special payments/benefits to its directors at their retirement to the remuneration policy, and disclose separately, the aggregate value of total special payments/benefits made to retiring directors during the respective financial year in the Annual Report.

### 2.2 Approvals for Banks, Branches and other Banking Outlets

- (a) During 2012, approvals were granted for opening 89 new branches, 73 Extension Offices (EOs), and 256 Student Savings Units; relocating 79 branches and 58 EOs; upgrading of 46 EOs to fully fledged branches and installing 57 off-site Automated Teller Machines (ATMs). These include approvals for opening 15 branches in the Northern and Eastern provinces. In addition, parallel to the 2012 budget

proposals on promoting financial inclusiveness, 41 SME Banking Centres (SBCs) were also approved during the year. As at the end of 2012, there were 2,203 branches, 4,171 other banking outlets and 2,390 ATMs in operation.

- (b) A letter of provisional approval was issued to establish a licensed commercial bank and the validity period of a letter of provisional approval issued in 2011 was extended.

### 2.3 Continuous Supervision of Banks

BSD continued to supervise banks on a continuous basis to assess their true condition, identify developments that may adversely affect an individual bank or the banking system as a whole, and initiate further examination or corrective action as required. Progress reviews of the rectification of concerns identified during statutory examinations and examining requests for other regulatory approvals are also carried out as part of continuous supervision. During the year, approvals were given for banks to include Subordinated Debentures in Tier II capital, amend the Articles of Association, borrow from overseas sources, grant facilities exceeding the maximum amount of accommodation, engage in the business of pawn broking and mobile banking operations and expand business in foreign countries.

In addition, an internal supervisory rating is also being carried out to supplement the continuous supervision process. In order to facilitate the continuous supervision mechanism through effective resolution of supervisory concerns, several meetings were held with the senior management and external auditors of banks.

During 2012, in addition to the reports on quarterly performance of the banking sector, several reports on specific matters such as analysis of interest spreads and interest margins of banks in Sri Lanka and a review on interest rates on housing and credit card loans were prepared to facilitate policy decisions.

### 2.4 Examination of Banks

BSD continued to adopt a risk based approach, focusing on identification of risks, management of risks and assessment of resources to mitigate risks. BSD conducted examinations of 12 banks that continued from the previous years and examinations of 20 banks that commenced in 2012. Accordingly, the examinations of 21 banks were completed in 2012 through formal discussions with the management of the respective banks and submission of reports to the Monetary Board, while 11 examinations were in the process of completion. These examinations highlighted concerns mainly in the areas of credit risk management, treasury operations, operational risk management, integrated risk management, compliance function, corporate governance and non-compliances with statutory regulations. In addition, several examinations of limited scope were also carried out on specific issues. Progress on corrective action taken to rectify key supervisory concerns was followed-up, quarterly.

### 2.5 Meetings of Banks' Chief Executive Officers

BSD continued to function as the secretariat for the Governor's monthly meetings with the Chief Executive Officers (CEOs) of licensed banks. This serves as a forum for exchanging views between the Central Bank and the banking sector. At these meetings, CEOs were apprised of banking sector performance and economic and monetary developments, to facilitate their decision making. The other matters discussed at these meetings include facilitating foreign currency encashment through banking outlets to promote foreign remittance through formal channels, promoting high standards of business on foreign exchange trading activities for efficient and smooth functioning of foreign exchange trading activities, migrating to new accounting standards and complying with existing prudential regulations, transmission and publication of the annual audited accounts and disclosure requirements under the Direction on Corporate Governance, timely submission of Management Letters to CBSL, issue of consultation paper on implementation of Pillar 2 – Supervisory Review Process under Basel II Capital Adequacy Framework, currency management issues such as handling unserviceable, low denomination currency notes by licensed banks, currency services to the general public and improving sorting standards and detection of counterfeit currency notes, reviewing the maximum interest rates on credit cards, housing loans, pawning advances and deposits and customer complaints in relation to high fees and charges of banks.

### 2.6 Administering the Sri Lanka Deposit Insurance Scheme (SLDIS)

In terms of the Sri Lanka Deposit Insurance Scheme regulations, No. 1 of 2010, the Deposit Insurance Unit in BSD is responsible for the operational and management arrangements of the mandatory Deposit Insurance Scheme established in the interest of the overall financial system stability of the country.

The Deposit Insurance Unit (DIU) continued to ensure collection of premia from member institutions, i.e., licensed banks and finance companies, and timely investment of funds in Government securities. SLDIS received Rs. 3.5 bn. as premium and penalty from member institutions in 2012. In addition to ensuring the smooth functioning of SLDIS, DIU has strengthened its operational mechanisms.

As at 31 December 2012, SLDIS comprised 78 member institutions with financial assets worth approximately Rs 8.8 bn. and a Fund balance of approximately Rs 9.7 bn.

### 2.7 Other Activities

#### (a) Handling Litigation

BSD, with the assistance of the Attorney General's Department and the law enforcement agencies handled 19 cases relating to corporate governance, affairs of the defaulted Pramuka Savings and Development Bank Limited, exchange control, disputed oil hedging transactions, alleged prohibited schemes and inappropriate banking practices.

**(b) Inter Regulatory Institutions Council (IRIC)**

BSD facilitated meetings of IRIC. The core objectives of forming IRIC were to ensure the formation of appropriate policy directions for the orderly development of the financial sector and all regulatory agencies coordinate and exchange information in the interest of wider financial system stability. The Council continued to deliberate on the draft Act on 'Sharing Information among Financial Sector Regulators', minimum capital requirement for stock brokers, share ownership limits of licensed banks, development of the corporate debt market and supervision of major financial groups.

**(c) Awareness Programmes and Capacity Building**

The fifth Bank Directors' Symposium on the theme of "Positioning the Banking Sector for the post \$4K era" was conducted on 12 December 2012, with a view to updating and sharing new developments in the economy and in the regulatory environment, in order to strengthen banks' resilience to meet challenges. Strengthening liquidity and operational risk management were also discussed. A technical session was conducted for the Boards of Directors and key management personnel of licensed banks for the purposes of enhancing knowledge and sharing experience on risk management practices and prudential standards. Further, a meeting was arranged with the auditors of licensed banks to apprise them of their role and responsibilities in carrying out audit functions of licensed banks. The staff of BSD have been the resource persons for many training programmes conducted by other Departments of the Central Bank and other outside institutions.

Several notices in newspapers listing banks and non-bank financial institutions that are licensed by the Central Bank to accept deposits from the public were published together with advertisements on obligations of customers and banks. During 2012, a more intensive public awareness campaign through Television and Radio was conducted by the Central Bank to educate the public on transacting with banks and the negative implications of engaging in prohibited schemes.

BSD also issued several press releases to disseminate information on changes made to the regulatory framework.

The supervision of banks helps to minimise the damage to the general public any mismanagement and failures of banks. During the year 2012, BSD effectively carried out its supervisory activities to ensure that licensed commercial banks and licensed specialised banks carried out their business in a manner that would not jeopardise their obligations to their depositors or creditors.

**Annex II-1****List of Licensed Banks****Licensed Commercial Banks**

1. Amana Bank Ltd
2. Axis Bank Ltd
3. Bank of Ceylon
4. Citibank, N.A.
5. Commercial Bank of Ceylon PLC
6. Deutsche Bank AG
7. DFCC Vardhana Bank PLC
8. Habib Bank Ltd
9. Hatton National Bank PLC
10. ICICI Bank Ltd
11. Indian Bank
12. Indian Overseas Bank
13. MCB Bank Ltd
14. National Development Bank PLC
15. Nations Trust Bank PLC
16. Pan Asia Banking Corporation PLC
17. People's Bank
18. Public Bank Berhad
19. Sampath Bank PLC
20. Seylan Bank PLC
21. Standard Chartered Bank
22. State Bank of India
23. The Hongkong & Shanghai Banking Corporation Ltd
24. Union Bank of Colombo PLC

**Licensed Specialised Banks**

25. DFCC Bank
26. Housing Development Finance Corporation Bank of Sri Lanka
27. Lankaputhra Development Bank Ltd
28. MBSL Savings Bank Ltd
29. National Savings Bank
30. Pradeshiya Sanwardana Bank
31. Sanasa Development Bank PLC
32. Sri Lanka Savings Bank Ltd
33. State Mortgage & Investment Bank

### 3. CENTRE FOR BANKING STUDIES

The Centre for Banking Studies (CBS) is entrusted with the responsibility of designing and conducting training programmes, seminars and workshops particularly to build capacity in the stakeholders of the financial sector and enable them to address the challenges of the fast changing environment. The focus of the CBS during the year 2012 was towards raising its standards to a higher level, both in terms of the quality of its training programmes and infrastructural facilities of the CBS. In a highly evolving financial world, the CBS identified the need to provide up to date knowledge via innovative means in a comfortable learning environment. The results of these changes were evident in its performance for the year 2012.

The CBS conducted seminars, workshops and conferences in the areas of banking operations and regulations, financial management, economics, rural sector development, human resource and general management, information technology, languages and communication skills. A wide array of programmes was developed with the intention of comprehensively addressing the training needs of financial institutions, both in terms of their core activities and support services. The CBS also continued to broaden its presence by expanding its links with other global resource centers. The commencement of the International Diploma in Compliance in collaboration with the International Compliance Association and the University of Manchester was a highlight in such development.

During the year 2012, the CBS conducted 61 calendar programmes, 50 special programmes (based on the demand from financial institutions and knowledge gaps identified by the CBS), 12 international programmes, 02 diploma programmes, 02 certificate programmes and 02 training of trainer programmes (for resource persons of the CBS). In addition, knowledge sharing events in the form of 09 public lectures, 04 evening presentations and 30 school programmes were conducted at the CBS in 2012. A total of 5,392 participants, including 115 foreign participants, patronised these events. The television series titled "Takshilawa", targeting Advanced Level students in Sri Lanka was telecast in 2012 as well under the purview of the CBS.

The CBS also commenced a series of regional level programmes in collaboration with the Provincial Offices Monitoring and the Regional Development Departments of the CBSL. A total of 16 such programmes were conducted involving all 05 provincial offices during 2012. The subject areas ranged from core banking activities such as Lending and Credit Evaluation to ancillary services, such as Pawn Brokering.

The CBS also designed its calendar and special programmes for 2013 and beyond, in line with the theme of "Raising the Quality and Outreach", for the CBS to be a centre of excellence in creating and sharing knowledge in the region.

### 4. COMMUNICATIONS

The main focus of the Communications Department (CMD) is to ensure efficient and effective communications with all stakeholders aiming at enhancing awareness of CBSL functions and policies, while ensuring the highest levels of professionalism, accuracy and integrity. Its scope also spans around enhancing sound knowledge and awareness of the CBSL staff on CBSL functions, policies, corporate and other departmental information whereby, bridging the knowledge gaps of the stakeholders of the CBSL, accomplishing CBSL's mission and strategic objectives.

Working towards this mandate, the CMD further broadened its reach to public at all social strata, by introducing a number of new communication facilities this year. The SMS Alert service on key information like the exchange and interest rates, Government securities auctions, inflation etc., is one such service. With the launching of this service, a convenient passage is now opened to the interested members of the public to access the Bank's information on their mobiles.

The CMD continued its other services for internal as well as external stakeholders such as maintaining the Trilingual corporate web site and the intranet site; the CBSL daily, launching advertising campaigns, conducting public awareness programmes both at CBS and at far corners of the country, continuing publications such as "Satahana", "Kavuluwa", "News Survey" and providing printing services to the Bank.

#### 4.1 External Communication

Improving the outlook of CBSL's corporate website; [www.cbsl.gov.lk](http://www.cbsl.gov.lk), the CMD introduced an image gallery which serves as a collection of professional photographs of the Bank and its activities. Proving the success of CBSL's corporate website as the Bank's prominent communication gateway, the site recorded 72 million visits during the year despite some technical inconveniences experienced at the beginning of 2012. This is a slight increase of 1.5% over the 71 million visits received in 2011. However, the 2012 visitor statistics did not reflect the real number of visits the site received, as the visitor data for several time periods during year 2012 were not available due to a technical failure which had occurred in the visitor tracking system of the site.

The Bank's journey into the world of rapidly growing social media networks which inaugurated in the previous year, saw popularity during the year 2012. The Bank had 734 posts in each of the Face book and Twitter. Pages Forty five videos too were uploaded to Youtube during this time. These posts and videos draw viewers' attention which was represented by 1,229 likes in Facebook, 429 followers in Twitter and 5,102 views in Youtube.

The SMS Alert system, the most recent addition to the armoury of communication tools of the CMD has 496 subscribers at present. The subscriber base is expected

to grow further in the future, with broadening awareness of this new service.

Continuing its communication through conventional channels as well, the CMD issued 1,792 press releases and 19 gazette notifications while publishing 447 advertisements in print media, during the year. The CMD produced and telecasted 10 video advertisements in three languages in 2012. The department organized 42 media conferences and interviews to communicate the views of the Monetary Board to the general public. In addition, the department provided media coverage to the programmes facilitated at CBSL and CBS. The CMD continued its presence at the Deyata Kirula exhibition, participating at the exhibition held at Oyamaduwa, Anuradhapura last year. The department's stall at the Colombo International Book Fair – 2012 also was one of the major visitor attractions.

#### 4.2 Internal Communication

"Cbsldaily" CMD's internal web site which was given a facelift with a more organized structure in 2012, served its internal readership with 440 SLIBOR and exchange rate updates, 352 press releases, 10 clubs and societies events, 12 CCPIs, on the site during the year. As an intranet site, it gained an encouraging popularity, having an average of 372 visits daily. Six volumes of "Kauluwa", the official internal newsletter of the Bank, were published in 2012 bringing information as well as entertainment to the staff of the Bank.

The media monitoring division submitted 1,611 news clips, articles and public opinions collected from fifteen national news papers published in three languages, updating the top management with current affairs on the economy and matters relevant to the Bank.

#### 4.3 Public Awareness

Enhancement of Public awareness on economics, finance and other Central Banking activities were among top priorities of the department, this year too.

The CMD coordinated and participated in 02 exhibitions representing the Bank during 2012, providing the general public with the opportunity of purchasing publications of the Bank and commemorative coins. The stalls of the Bank at these exhibitions; Deyata Kirula National Exhibition held at Oyamaduwa and the Colombo International Book Fair held at BMICH were very popular among the people of all ages and walks of life.

The publications of the Bank play a vital role in taking the Banks policy opinions and views to the general public, especially to the younger generation. Therefore, the sales and distribution volume of the Bank's publications reflects the success of this awareness building effort. The year saw sheer success in sales totaling Rs. 5.4 million during 2012, while distributing 12,000 copies of different publications, including Annual Report 2011, free of charge among school children and teachers.

The department organized 51 public awareness/ educational programmes during the year targeting Advanced Level students, school teachers, and trainees of armed forces and officers. Twentytwo of these programmes were held outside Colombo i.e. Trincomalee, Matale, Galle, Hambantota, Dehiattakandiya, Polonnaruwa and Kandy. The programmes were attended by a total of 7,523 participants which was a 43 per cent increase over the previous year.

#### 4.4 Tamil Translation Services

The Tamil Translation unit of the department this year completed a major project of National importance i.e. translating the LLRC report which contained 747 English pages, into Tamil. Meanwhile, the unit continued its usual services to the departments of the Bank uninterrupted, completing 279 assignments which contained a total of 2,369 pages during the year 2012.

#### 4.5 Printing Press

The printing press completed 215 printing assignments, maintaining the highest quality standards. Apart from these assignments, the press printed 33,000 visiting cards for the Bank's officers during the year.

Some of the important assignments undertaken by the press were, Road Map 2012, Monthly Bulletin, Kauluwa, Satahana, News Survey, Financial System Stability Report - 2011, Programme Calendar of the CBS, Strategic Plan of the Central Bank of Sri Lanka, Public Debt Bulletin, Enumeration of Vital Statistics, Humanitarian Operation, Arising, 60th Anniversary Oration Series, 60th Anniversary Publication, Data Folder - 2012, Economic and Social Statistics, Direction Books for Specialized Leasing Companies and Registered Finance Companies, CBSL Diary-2013 etc.

#### 4.6 Photographic Coverage of Major Events of the Bank

Bringing the Central Bank to the world in "colour", the Photographic Unit of the CMD covered 236 events of the Bank by camera; still and video, and delivered all related services including editing and printing of photographs, video editing, preparation of albums, CDs and framing of photos, with the excellent quality it always produces.

#### 4.7 Library and Information Centre

The Library and Information Centre (LIC) continued its service through the accumulation and distribution of knowledge assets for the Bank, during the year 2012. 280 new books, 88 reports, 699 journals, 9 international titles, 65 country studies, 538 Government publications were among these assets added to the LIC's collection during the year. With these additions the LIC now possesses a collection of 26,743 books, 17,968 reports, 1,806 CDs while having subscribed to 182 renowned foreign and local journals in addition to the online database 'Science Direct' which provides subscribed online access to over 80 journals on Economics, Econometrics and Finance.

During the year the LIC continued its effort to inculcate the habit of CBSL officers to debate on new ideas and to share knowledge relevant to every aspect of the CBSL. Two events; a book exhibition where newly purchased titles were put on display and a book fair where 06 reputed booksellers participated, were held during the year, providing Bank employees an easy passage to fresh knowledge.

Several changes were made to the Selective Dissemination of Information service of the LIC to keep on par with users' needs. Innovative electronic alert services such as Recent Additions (i.e. new books), Table of Contents Service (TOC Service), Central Bank Alert, News Alert, Local Press and alerts on current issues channeled through email and CBSL daily, offered users an excellent service in this regard.

In an effort to improve the services with users' participation, LIC initiated a survey on knowledge requirements starting with two key departments during the period under review.

Three "Book introducing sessions" were held during the year with the objective of cultivating the reading habit among the bank employees.

Keeping up with the ever-changing world, LIC took the challenge of preserving CBSL knowledge and initiated the CBSL Knowledge repository, giving access via the LIC intranet page.

LIC, the knowledge asset base with a national importance, doesn't confine its service to Bank staff, but extends to outside institutions as well, on their requests.

## 5. CURRENCY

The Monetary Law Act No. 58 of 1949 (MLA), Section 48 to 59A provides the Monetary Board with the authority to issue currency as a means of payment in Sri Lanka. Within this given mandate, the Currency Department (CRD) of the Central Bank of Sri Lanka (CBSL) is assigned with the responsibilities of issuing notes and coins to facilitate the payment system, accepting currency deposits from LCBs to maintain the statutory reserve requirement, withdrawing unfit notes and coins from circulation and taking necessary measures to prevent offences related to currency, including counterfeiting.

### 5.1 Currency Issue

The CRD issued both notes and coins to the economy through Licensed Commercial Banks (LCB) by way of new issues and re-issue of fit (serviceable) notes and coins during 2012 as given in Table II-1 below. This resulted in the value of currency notes and coins in circulation being at Rs.318.1 billion on 31.12.2012, representing an annual increase of 8.5 per cent over currency in circulation on 31.12.2011.

**Table II - 1** Currency Issue

In Rupees

Item	New	Serviceable	Total
Notes	74.8 billion	280.6 billion	355.4 billion
Coins	747.3 million	1.4 million	748.7 million

CRD also issued currency to the public through its currency exchange counters maintained by the Bank of Ceylon, Pettah Branch (BOCPB). In 2012, Rs. 3,925 million worth of currency notes and Rs. 152.8 million worth of coins were issued to the public and this operation was monitored on a quarterly basis.

In order to meet the demand for currency notes and coins in the economy and ensure good quality notes in circulation, the CRD made arrangements to print 215 million pieces of currency notes and mint 197.5 million pieces of coins during 2012.

CRD made arrangements to procure new coin stock for 2013-2015 by calling international tenders.

The CBSL issued two new commemorative coins in 2012 as given in Table II-2 below. Accordingly, the total number of commemorative coins issued by the CBSL since its establishment increased to 57.

**Table II - 2** Commemorative Coin Issue

Description	Face Value
100 years of Scouting in Sri Lanka (Nickel plated steel circulation standard commemorative coin)	Rs. 2
60th Anniversary of Sri Lanka - Japan Diplomatic Relations (Special silver commemorative coin)	Rs. 1,000

### 5.2 Acceptance of Deposits of Currency

The Licensed Commercial Banks (LCBs) deposited with CRD both fit and unfit (unserviceable) currency as shown in Table II-3 below, to meet the statutory reserve requirement. The fit (serviceable) currency deposited was processed by CRD and reissued to LCBs.

**Table II - 3** Currency Deposits

In Rupees

Item	Serviceable	Unserviceable	Total
Notes	285.9 billion	45.3 billion	331.2 billion
Coins	3.0 million	-	3.0 million

To facilitate the efficient and speedy processing of the increased volume of currency deposits, measures were taken for further automation of currency operations by

CRD. Actions were initiated to procure machinery with advanced technology to increase efficiency, minimise risks and provide an environment friendly currency disintegration system.

### 5.3 Withdrawing Unfit Notes from Circulation

Unfit currency notes deposited by LCBs are replaced by issue of new or fit currency notes. CRD destructed 159.6 million unfit notes to the value of Rs 38.9 billion.

As good handling practices extend the life span of notes and reduce the cost of printing new notes, prominence was given for the implementation of the clean note policy with following measures.

- (a) Issued Guidelines to commercial banks on sorting standards of currency notes, and instructed to provide exchange facility of unfit currency notes to public.
- (b) Conducted meetings with cash managers on currency sorting and other currency handling practices.
- (c) Carried out checking of random samples of notes deposited by commercial banks, to ensure strict compliance by commercial banks to guidelines.
- (d) Conducted an extensive publicity campaign through TV advertisements, radio discussions, posters and seminars to educate the public, to exchange their unfit currency notes through LCBs.

### 5.4 Measures Taken to Prevent Offences Related to the Legal Tender

Various measures were taken by CRD in 2012 to prevent offences such as mutilation, defacement, reproduction (including counterfeiting) and misuse of currency notes and coins.

- (a) Closely co-operated with the Counterfeit Currency Bureau of the Criminal Investigation Department (CID) of the Police and law enforcement authorities pertaining to counterfeiting attempts. Counterfeit notes detected in 2012 were at the same level as in 2011, which was six notes per million genuine notes in circulation.
- (b) Issued 177 certificates with the Governor's signature as conclusive evidence of imitation of a currency note for proceedings in Courts.
- (c) Officers of the CRD attended 11 court cases as witnesses on counterfeiting.
- (d) Issued circulars to all LCBs for strengthening their currency operations to detect counterfeit notes and prevent counterfeit notes from getting in to circulation.
- (e) Obtained approval from the Monetary Board for a policy on reproduction of Sri Lanka currency notes by various entities and persons for permitted purposes, subject to conditions stipulated by the Monetary Board.

## 5.5 Other Activities

### (a) Public Awareness

In order to increase public awareness on security features of currency notes, use of quality notes and good handling practices of currency notes and coins, the CRD carried out multi-pronged activities during the year as described below.

- (i) Conducted 26 seminars/workshops, participated in 4 radio programmes and telecasted 02 TV advertisements. The audience included bank officers, cash handlers, police officers, schoolchildren, government and private sector employees and the general public.
- (ii) Conducted workshops for schoolchildren in schools where currency circles were established.
- (iii) Participated in the national development exhibition "Deyata Kirula – 2012" held at Anuradhapura from 4th – 10th February 2012 and 4 other exhibitions during the year along with CRD Mobile Museum with a view to enhancing public awareness on currency notes and coins and its historical developments in Sri Lanka.
- (iv) Facilitated 6,893 visitors at the 03 money museums of CBSL.

### (b) Design of Rs 10 Coins to Depict District Features

CRD has planned to issue a series of Rs. 10 coins to reflect special features of each administrative district. An island wide competition was conducted to select designs for the proposed Rs. 10 coin series.

### (c) Coin Collection Programme

CRD issues coins to LCBs to meet the demand by incurring a very high cost for minting each year. However, a large number of coins lie idle without getting into circulation, in various places such as religious places and tills. Therefore, CRD commenced a coin collection drive to collect idle coins from the 4th quarter 2012 in order to reduce the cost of minting new coins.

## 6. DOMESTIC OPERATIONS

The Domestic Operations Department (DOD) carries out its major functions under the mandate conferred in Part V, Chapter V and VI of the Monetary Law Act to the Central Bank of Sri Lanka (CBSL) for conducting Open Market Operations (OMO); enforcing Statutory Reserve Requirement (SRR) and offering banking services to commercial banks and to the Government.

The department also facilitates the maintenance of the efficient and effective domestic e-payment and settlement system, by offering Intra Day Liquidity Facility (ILF) to commercial banks and primary dealers for smooth functioning of payments and settlements under the Real Time Gross Settlement System (RTGS).



## 6.1 Functions of the DOD

DOD conducts OMO with the objective of steering short term interest rates at the desired level within the policy interest rate corridor determined by the Monetary Board. The policy interest rates known as repurchase and reverse repurchase rates are reviewed on a monthly basis by the Monetary Board and the interest rate corridor determined upon such revision, forms the basis for open market operations. Standing facilities at the policy rates referred above are also offered on a daily basis, creating the floor and the ceiling for the OMO. The department also enforces statutory reserve requirement against the deposit liabilities of the licensed commercial banks (LCBs), as determined from time to time by the Monetary Board.

## 6.2 Implementation of Monetary Policy

DOD conducts monetary policy operations mainly through open market operations and standing facilities, to inject and absorb liquidity to and from the market, depending on supply and demand conditions, to maintain short-term interest rates to suit the monetary policy stance during a given period.

The year 2012 started with a deficit position of market liquidity and experienced a more frequent shifting between surplus and deficit during the year. Frequently fluctuating liquidity levels induced short-term interest rates to stay close to the ceiling of the policy rate corridor in the early part of the year.

In addition to the upward revision to the policy rates in Feb 2012, CBSL re-imposed a policy of limiting the repo standing facility up to a maximum of Rs.100 million per participating institution (PI) on the days when the Central Bank offers reverse repo auctions, to increase market participation. The limitation on the repo standing facility was helpful in managing liquidity pressure by compelling surplus banks to lend in the market. Moral suasion was adopted whenever necessary to communicate to market participants on changing market conditions. Hence, the participants were seen increasingly engaged in lending among themselves before reverting to Central Bank for placement of excess funds.

Liquidity in the interbank market witnessed its peak Rs.58.8 billion in July 2012, consequent to the conversion of part of the sovereign bond proceeds by the Government. The surplus was absorbed primarily from outright sales of treasury bills out of CBSL holdings, serving of foreign currency obligations of the Government and maturity of buy-sell FX swaps entered by CBSL with commercial banks during a very short period of time. Market liquidity was back in deficit during the last quarter of 2012. Although the domestic market liquidity deficit

was aggravated by seasonal currency demand, the CBSL was able to fill the liquidity short-fall by injecting liquidity through the term reverse repurchase auction in the fourth quarter of 2012.

The department was able to manage market liquidity using both active and passive instruments, facilitating the realization of monetary targets while maintaining the tax adjusted inter-bank overnight market interest rate within the corridor. The weighted average inter-bank overnight money market interest rate, which was above the upper bound of the corridor at the beginning of 2012 continued to stay around the same level during the year, except in a few days in April. However, tax adjusted weighted average call market interest rates remained generally within the corridor, though close to the upper bound. The volatility of the call rates that continued during the first half of the year was more or less stabilized, though close to the upper bound of the policy rate corridor, responding to policy measures adopted as well as to frequent open market operations conducted during the second half of 2012. Weighted average call money rates were shifted to the middle of the CBSL policy rate corridor with the downward revision of policy rates in December 2012.

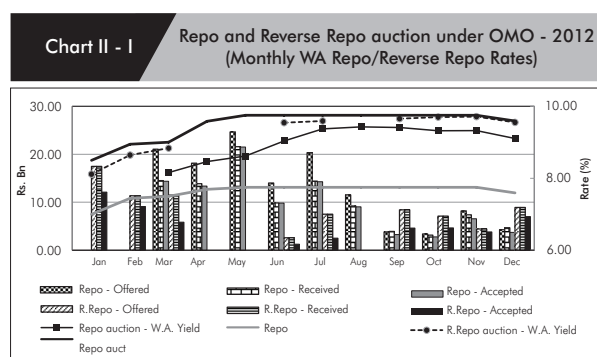
### (a) Open Market Operations

#### (i) Overnight Repo Transactions

The liquidity surplus within the banking system was mainly absorbed on a daily basis by conducting auctions to sell Government Treasury Bills from the CBSL holdings, on a repurchase basis. On average, about Rs.16 billion per day was offered at the auction and accepted volume represented 51 per cent of the actual surplus liquidity on days of surplus. The weighted average yield rate of overnight repo auction (chart II-I) varied between 8.10 per cent and 9.50 per cent. The weighted average repo rate moved within the corridor, highlighting stable market conditions.

#### (ii) Overnight Reverse Repo Transactions

In 2012, market liquidity continued to swing between deficit and surplus positions and created an increased upward pressure on overnight interest rates. Thus, reverse repurchase auctions continued during the year to ease off the above mentioned upward pressure as and when appropriate. On average, about Rs.7.4 billion per day was offered at the auctions at a weighted average yield rate varying between 7.90 per cent and 9.70 per cent (chart II-I). Further 53 per cent of the market liquidity requirement was supplied through the overnight reverse repo auction on days of market liquidity shortfall.



## (b) Term Transactions

### (i) Term Repo Transactions

Under the term repo auctions CBSL absorbed Rs.8.7 billion worth of excess market liquidity on term basis during the year. The tenure of the term repo auctions varied between 7 days and 14 days. The weighted average yield rates hovered between 8.80 per cent and 9.50 per cent during the year.

### (ii) Term Reverse Repo Transactions

During the year 2012, CBSL conducted Term Reverse Repo auctions to buy Treasury bills and bonds as a strategy to inject liquidity to the market on a relatively longer term basis. The period of the term reverse repo auctions varied between 7 days and 31 days whilst the weighted average yield rate varied between 9.60 per cent and 10.30 per cent. Total volume injected throughout the year was Rs. 51 billion.

## (c) Standing Facilities

Standing facilities were provided at the CBSL Repurchase rate and Reverse Repurchase rate to PIs who were unable to manage their short-term fund requirements fully, through the interbank money market and the daily OMO auctions throughout the year. The repurchase transactions under the standing facility for the year 2012, reported a daily average of about Rs. 5 billion per day and total of Rs.1,314 billion. The total of reverse repurchase transactions under the standing facility were Rs.321 billion for the year 2012.

## (d) Outright Transactions

The CBSL conducted outright sale auctions to sell Treasury bills out of its own portfolio, in order to absorb excess liquidity on a permanent basis. Total value of Treasury bills sold through outright sales auctions amounted to Rs. 18.5 billion in 2012. The tenure of the Treasury bills sold ranged from 10 days to 39 days while the yield rates ranged from 10.69 per cent to 10.98 per cent.

## (e) Statutory Reserve Requirement (SRR)

The SRR is a minimum reserve that each commercial bank is required to hold in terms of the regulations of the CBSL in the reserve account with the CBSL in proportion

to the deposit liabilities of each bank. The DOD is responsible for both administering and maintenance of SRR and monitoring compliance by commercial banks. This was maintained at 8 percent of deposit liabilities during the year.

## (f) Bank Rate

The Central Bank's rate of interest (Bank rate) on short term advances to licensed commercial banks, stipulated under Section 87 of the Monetary Law Act, remained unchanged at 15 per cent. However, this rate was only of academic interest during the year as no bank resorted to borrowing from CBSL at the Bank rate.

## 6.3 Banker to Commercial Banks and the Government

### (a) Accounts of Financial Institutions

DOD provided current account facilities to commercial banks and primary dealers, to ensure an efficient inter bank payment and settlement system, thus facilitating the Central Bank's role of being the Banker to commercial banks. At the end of 2012, CBSL maintained accounts for 24 commercial banks and 10 primary dealers. These accounts were operated on a Real Time Gross Settlement basis within the Automated General Ledger system of the Bank.

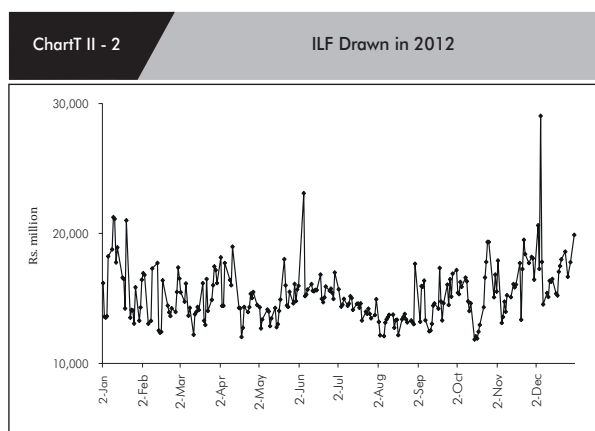
### (b) Government Accounts

The department also maintained the accounts of government departments, government agencies and institutions and certain statutory boards, providing them with required banking facilities in performing its functions as the Banker to the government. The total number of accounts maintained by CBSL amounted to 56 as at end 2012. In terms of Section 89 of the Monetary Law Act, CBSL provides provisional advances to the government, free of charge, with the ceiling being 10 per cent of the estimated government revenue in a given fiscal year. During 2012, the value of the provisional advance so extended has increased by Rs.5.1 billion to Rs.113.0 billion corresponding to the higher government revenue estimated for the year 2012.

## 6.4 Provision of Intra-Day Liquidity Facility (ILF)

DOD ensured the smooth and efficient functioning of the RTGS system by providing ILF to PIs. This facility was provided free of charge against the collateral of Treasury bills and bonds, which were valued at their current market prices with a sufficient hair cut to absorb any variations in market prices during the day.

The total value and average daily value of ILF drawn during the year amounted to Rs.3,692 billion and Rs.15 billion respectively. This shows an increase in ILF utilization over that of the previous year amounting to a total of Rs.2,781 billion with an average of Rs.12 billion respectively.



## 7. ECONOMIC RESEARCH

As per the Monetary Law Act (MLA), the Economic Research Department (ERD) was established at the time of the establishment of the Central Bank in 1949. Accordingly, ERD was vested with the function of preparing data and conducting economic research for the guidance of the Monetary Board and the Governor in formulating, implementing, and executing policies and measures and for the information of the public, in the areas of money and banking and other economic subjects of general interest. In discharging such responsibilities, the MLA vested the authority with the Director of Economic Research or any officer of ERD to require any person to furnish him any information that he may consider necessary or require any person to produce for inspection any books or records in his possession containing or likely to contain any such information. Any person without reasonable cause failing or refusing to comply would be found guilty of an offence.

ERD performed its overall responsibility of maintaining economic and price stability to facilitate sustainable growth in the country through providing proactive and timely policy recommendations to the Monetary Board, Management and Committees it is represented in including the Monetary Policy Committee (MPC). In discharging such activities, the ERD conducted comprehensive research in the areas of money and banking and other economic subjects of general interest and provided necessary data and information for the guidance of the Monetary Board and the Governor in formulating, implementing, and executing recommended policies and measures. In discharging the Central Bank's role as an economic advisor to the Government, ERD continued to provide proactive policy advice and recommendations on emerging economic issues and fiscal policy measures required for maintaining macroeconomic stability and the impact of fiscal policy measures already adopted on the macro economy. Further, ERD published its statutory and other publications on a timely and regular basis. In addition, ERD continued to disseminate information on monetary policy measures and other economic information to all stakeholders as well as the general public through regular press releases and by updating the Central Bank website to provide the latest data and information. Apart from

performing its statutory obligations, the senior officials of ERD participated in various policy advisory committees set up by the Government and regularly represented the Central Bank at domestic and international forums and conferences. Further, the officers of ERD continued to act as resource personnel in both domestic and international capacity building initiatives.

### 7.1 Conducting Research to Assist Monetary Policy Formulation

ERD continued to prepare comprehensive reports on economic and monetary analyses for monthly MPC meetings and on a regular basis to the Monetary Board. The MPC was continually updated on the state of the economy by providing analysis of global economic developments and its impact on the domestic economy, developments in inflation including supply and demand side analysis of inflation and inflation projections, the developments and issues in key macroeconomic sectors and developments in capital and financial markets to facilitate monetary policy recommendations to the Monetary Board.

The econometric modeling framework developed by ERD for forecasting inflation was continued. Meanwhile, an output gap analysis has been initiated and alternative measures of the output gap have been estimated. The preliminary findings were presented to the MPC to facilitate the process of timely and accurate monetary policy decision making. Further, a "Macroeconomic Modelling Unit (MMU)" was established within ERD in the fourth quarter of 2012 to further encourage and facilitate the research culture among ERD officers. ERD also called for assigning officers from other departments of the Bank to the MMU and tasked each officer assigned to the unit to complete a comprehensive research paper of publishable quality. These measures strengthened the efforts to provide evidence based policy recommendations to the MPC and the Monetary Board while enhancing the quality of the research papers published by the Central Bank.

ERD successfully held its International Research Conference (IRC) in 2012 for the fifth consecutive year. IRC provides an opportunity to present and discuss theoretical and empirical research conducted by both Sri Lankan and international researchers, particularly in the region. After a rigorous selection procedure, 8 papers were presented out of 48 research papers received for the conference. Researchers from Bangladesh, Germany, India, Pakistan and Sri Lanka presented their findings at IRC, 2012.

Further, officers of ERD continued their joint research programmes with International Organisations such as the South East Asian Central Banks (SEACEN) Research and Training Centre, internal research working groups and with their research advisors from postgraduate engagements.

ERD conducted 20 seminars in 2012 under the Departmental Seminar Series covering current economic interests and provided a platform for knowledge sharing among the officers. Further, the officers of ERD organised

a number of special seminars either collaboratively or inviting professionals in various sectors enabling the Central Bank to discuss emerging economic issues and to ascertain first-hand information about such issues.

A new trade data classification system in terms of the National Import Tariff Guide 2010/2011 was introduced while compilation of the new trade index based on 2010 base year was completed and published in the Annual Report 2011. The revision of the Monthly Industrial Production Volume Index (MIPVI) from the existing International Standards on Industrial Classification (ISIC) revision II to a more comprehensive ISIC revision IV was completed to fully reflect the structural changes taking place in the industrial sector. Also, the base period for the Agriculture Production Index was revised to 2007-2010 from 1997-2000.

During the year, the compilation of the monetary survey in line with IMF Monetary Statistics Standards and transition from the current Balance of Payments Manual (BPM) 5 to BPM 6 in compiling Balance of Payments (BOP) statistics were initiated.

The Monetary Policy Consultative Committee (MPCC), which was established to strengthen the monetary policy decision making process by obtaining views of the private sector, was strengthened with the addition of two members; Mr. Mohan Pandithage and Dr. Indrajit Coomaraswamy, in 2012. MPCC currently comprises 10 members and functions under the Chairmanship of Mr. Mahen Dayanada.

## 7.2 Preparation of Statutory and Other Reports/Publications

As per statutory requirements under the MLA, ERD prepared the Annual Report of the Central Bank for 2011 and presented it to the Minister of Finance and Planning within the stipulated time period with the assistance of other Departments of the Bank. In addition, Recent Economic Developments- Highlights of 2012 and Prospects for 2013 and Monthly Bulletins were also published. As per requirements under the Section 116(1) of the MLA, the September 15th Report was also submitted to the Minister of Finance and Planning incorporating an analysis of economic performance during the first half of the year and the outlook for 2012, effects of fiscal policy on implementation of monetary policy of the Central Bank and its objective of price stability as well as some policy proposals to be used for the preparation of the 2013 budget of the Government.

Further, 12 press releases each on monetary policy and external sector performance were released to communicate the latest developments in the economy and to improve transparency of monetary policy operations. Through these press releases and other specific press announcements, ERD continued to disseminate policy changes and statistics on monetary policy, balance of payments and international trade and any other important economic matter on a regular basis to the general public.

For the sixth year running, the policy statement of the Central Bank, "Road Map Monetary and Financial Sector Policies for 2012 and Beyond", was prepared and announced to the public on 3<sup>rd</sup> January 2012.

The purpose of the Road Map was to enhance the predictability and transparency of the Central Bank's policies, which would help stakeholders to design and better calibrate their own plans and strategies for the future with those of the economy. Towards the end of 2012, a similar policy statement was prepared for 2013 and beyond as well, which was announced on 2<sup>nd</sup> January 2013.

In 2012, as in previous years, independent views and recommendations of ERD were provided on 68 cabinet papers which had important economic and monetary implications. Further, ERD provided comments and observations on various matters referred to the Central Bank by Government Ministries/ Departments/ Institutions. In addition, ERD continued to evaluate monetary implications of foreign loans obtained by the Government and its agencies and make recommendations to the Monetary Board. ERD was also called in for a major project of national importance; coordinating the complete translation work of the Lessons Learnt and Reconciliation Commission (LLRC) report and taking upon the responsibility of Sinhala translation with the assistance of its staff and staff of selected other departments.

## 7.3 Contribution to Knowledge Enhancement and Sharing of Expertise

ERD contributed immensely to enhance the knowledge on the subject of economics providing its expertise at both local and international programmes. Officers of ERD worked as resource persons in various educational programmes organised by universities, the Centre for Banking Studies (CBS), Sri Lanka Institute of Development Administration (SLIDA), schools and various other Government and private institutions. The officers continued to make presentations on central banking and macroeconomic developments to both local and foreign delegations visiting the Central Bank. In addition, senior officials of ERD engaged in the evaluation of research papers submitted by postgraduate aspirants of the Central Bank and the necessary guidance was given in the preparation of research proposals and research papers.

Senior officials of ERD served on various Committees and Boards within and outside the Bank. Representations at outside committees included, Committees of, Determination of Commercial Price of Fertilizer, Management Committee at the Ministry of Higher Education (HMC), National Committee on Socio Economic and Policy Analysis at the Sri Lanka Council for Agricultural Research and Policy (CARP), Committee on Analyzing Labour and Social Trends in Sri Lanka -2011, Steering Committee on Health Care Financing, Steering Committee on National Health Accounts, Ministry of State Resources and Enterprise Development Committee on Restructuring Eight Plantations in Janatha Estate Development Board, the team assigned with the task of formalising and operationalising the establishment of the five hubs (Knowledge, Commercial, Maritime, Aviation and Energy) as envisioned by the government, Sub-committee on establishment of a Global Business Centre, Steering committee for the operationalization of the Commercial Hub, the working group appointed to address the issues relating to improving the Doing Business Index of Sri Lanka, Committee on Public

Enterprises, Foreign Currency Inflows Committee, Committee on Issue of Sharia Compliant Government Securities, Technical Evaluation Committee on Off-shore Oil Exploration in Gulf of Mannar and Tourism Satellite Account (TSA) programme. In addition, ERD represented the Bank at meetings conducted by various Ministries including the Ministry of Finance and Planning and other Government and private agencies.

#### 7.4 International Relations

ERD continued to coordinate with multilateral organisations such as the International Monetary Fund (IMF), World Bank, the Asian Development Bank (ADB), SEACEN, SAARCFINANCE and SEANZA on behalf of the Central Bank and the Government. ERD closely worked with IMF staff missions that visited Sri Lanka to review the IMF- SBA (Stand By Arrangement) facility during the year and discharged the responsibility of regular data reporting under the IMF- SBA facility. The IMF-SBA programme, which commenced in July 2009, was successfully completed in July 2012 with Sri Lanka receiving all the funds approved under the SBA in 2009. Further, ERD closely monitored the performance criteria given under the IMF- SBA facility and possible measures were proposed to the management and to the Ministry of Finance and Planning to take necessary action to achieve the targets. Another mission on IMF-SDDS (Special Data Dissemination Standard) was also entertained in 2012. ERD closely worked with three international sovereign rating agencies, namely; Fitch Ratings, S&P Ratings and Moody's Ratings and three Rating Advisors to upgrade the country rating in 2012. Further, ERD undertook to address all policy related inquiries and extended all documentary support and presentation of economic updates for the successful completion of the sovereign bond issue.

Officers in ERD were also engaged in organising the Public Debt Manager's Forum, SEACEN-IMF Course on "Macroeconomic Diagnostics" and conducted a number of familiarisation and training programmes for SAARCFINANCE Staff Exchange programmes.

### 8. EMPLOYEES' PROVIDENT FUND

The Employees' Provident Fund (EPF/the Fund), the largest superannuation fund in Sri Lanka, was established under the Employees' Provident Fund Act No.15 of 1958 to provide retirement benefits for semi government and private sector employees. In terms of the provisions of the Act, the Commissioner General of Labour functions as the general administrator of the Fund while the Monetary Board of the Central Bank of Sri Lanka is entrusted with the powers, duties and responsibilities to function as the custodian of the Fund. The Monetary Board has empowered the Employees' Provident Fund Department of the Central Bank to function as the operational arm in performing its functions.

#### 8.1 Functions of the Department

The EPF Department is entrusted with responsibilities of collection of member contributions and surcharges, maintenance of member-accounts, investment of surplus funds, charging the expenditure incurred by the

Monetary Board and Commissioner General of Labour in the performance of their duties and functions, crediting interest to member accounts, payment of benefits to beneficiaries of the Fund. The EPF Department was engaged in the above activities during 2012 as per the policies approved by the Monetary Board and in close collaboration with the Commissioner General of Labour.

### 8.2 Performance of the Activities

#### (a) Membership, Member Balances and Refunds

The total number of member accounts reached 14.25 million by end of 2012, which was an increase of 1.8 per cent compared to 14 million recorded at the end of 2011. The number of contributing member accounts increased to 2.25 million by end 2012 from 2.21 million as at end 2011. Meanwhile, the number of contributing employers increased to 68,771 by end 2012 from 64,562 at the end of 2011.

The total value of the Fund stood at Rs. 1,144 billion as at end 2012 compared to that of Rs. 1,018 billion by end 2011. This was an increase of 12.4 per cent. This increase was due to the growth in the contributions made on behalf of the members and the income generated through the effective and prudent management of the Fund. Total liability to the members stood at Rs. 1,125 billion as at end 2012 recording a 14.1 per cent increase from Rs. 986 billion as at end 2011 (Table II-4). This includes the interest income credited to member accounts as at end of each year. The net contribution (gross contribution less refunds of benefits) also increased to Rs. 21.5 billion compared to Rs. 14.6 billion in the previous year. The total amount of refunds made to the members and their legal heirs in 2012 was Rs. 48.7 billion, which was an increase of 3.0 per cent over 2011.

**Table II -4 Selected Key Information of the Fund**

Item	2011	2012 (a)	Change (%)
Total number of member accounts (mn)	14.00	14.25	1.8
Contributing member accounts (mn)	2.21	2.25	1.8
Non-contributing member accounts (mn)	11.79	12.00	1.8
Contributing employers	64,562	68,771	6.5
Total contributions (Rs.bn)	61.9	70.2	13.4
Total refunds (Rs. bn)	47.3	48.7	3.0
Number of refunds	120,301	115,654	(3.9)
Total liability to members (Rs.bn)	986	1,125	14.1
Total value of the Fund (Rs.bn)	1,018	1,144	12.4

(a) Provisional Source : EPF Department, Central Bank of Sri Lanka

#### (b) Investment of Funds and Return

(i) **Investment Portfolio:** The total investment portfolio (Book Value) of the Fund grew by 12.2 per cent from Rs. 985.6 billion in 2011 to Rs. 1,105.5 billion in 2012 (Table II-5). The investment policy of the Fund continued to focus on providing a long-term positive real rate of return to the members while ensuring

the safety of funds and maintaining a sufficient level of liquidity to meet refund payments and other expenses of the Fund. Accordingly, the investment portfolio consisted of 93.6 per cent in government securities 5.4 per cent in equity and 0.7 per cent in corporate debentures. The remaining 0.3 per cent was invested in high liquid assets such as Reverse - Repos on government securities to maintain the day to day liquidity requirement.

**Table II -5 Investment Portfolio**

Type of Investment	2011		2012 (a)	
	Amount (Rs.bn.)	Share (%)	Amount (Rs.bn.)	Share (%)
Treasury bonds & bills	874.6	88.7	1,012.1	91.5
Rupees Loans to Government	23.1	2.3	23.1	2.1
Corporate Debentures	9.2	1.0	8.0	0.7
Equity	75.9	7.7	59.2	5.4
Reverse Repos	2.8	0.3	3.1	0.3
<b>Total</b>	<b>985.6</b>	<b>100.0</b>	<b>1,105.5</b>	<b>100.0</b>

(a) Provisional Source : EPF Department, Central Bank of Sri Lanka

(ii) **Investment Income:** The Fund earned a total income of Rs. 121.4 billion in 2012, an increase of 4.6 per cent compared to the previous year (Table II-6). Interest income was the major source of income (74.9 per cent of the income) to the Fund. Interest income grew by 7.4 per cent from Rs. 84.7 billion in 2011 to Rs. 90.9 billion in 2012. Government securities held by the fund generated a weighted average rate of return of 11.1 per cent and the yields of those securities varied between 9.8 per cent and 12.7 per cent. The equity portfolio generated an income of Rs. 3,016 million in 2012, compared Rs. 2,678 million earned in 2011 indicating an increase of 12.6 per cent. These gains include capital gains and dividends realized during the year (Table II-6).

**Table II -6 Income on Investments**

Source of Income	2011		2012 (a)	
	Amount (Rs.mn.)	Share (%)	Amount (Rs.mn.)	Share (%)
Interest	84,673	73.0	90,904	74.9
Amortized gain	28,727	24.7	27,792	22.9
Capital gain from Government Securities	10	..	34	..
Marked to market gain/ (loss)	(267)	(0.2)	(388)	(0.3)
Capital gains from Equity	715	0.6	1,020	0.8
Dividends	1,963	1.7	1,996	1.6
Other	222	0.2	55	0.1
<b>Total</b>	<b>116,043</b>	<b>100.0</b>	<b>121,413</b>	<b>100.0</b>

(a) Provisional Source : EPF Department, Central Bank of Sri Lanka

**Table II -7 Maturity Profile of Government Securities Portfolio - End of 2012**

Maturity	Amount (Rs. mn.)	Share (%)	Weighted Average Yield (%)
Less than 1 year	231,193	22.3	12.7
1-2 years	126,146	12.2	9.8
3-4 years	209,817	20.3	10.1
More than 5 years	468,082	45.2	11.1
<b>Total</b>	<b>1,035,238</b>	<b>100.0</b>	<b>11.1</b>

(a) Provisional Source : EPF Department, Central Bank of Sri Lanka

(iii) **Expenditure:** Total operational expenditure of the Fund amounted to Rs. 948 million in 2012 compared to Rs. 786 million in 2011, which was an increase of 20.6 per cent (Table II-8). Total operational expenditure was maintained at 0.78 per cent of its total gross income in 2012, compared to 0.68 per cent in 2011. Over the years, the Fund has maintained its operational expenditure below 1 per cent of the total gross income.

**Table II -8 Operational Expenditure**

Item	Amount (Rs.mn.)		Change (%)
	2011	2012(a)	
Personnel Expenses	417	514	23.3
Administrative Expenses	335	397	18.5
Other Expenses	34	37	8.9
<b>Total</b>	<b>786</b>	<b>948</b>	<b>20.6</b>
<b>Total Expenses as a % of Gross Revenue</b>	<b>0.68</b>	<b>0.78</b>	<b>-</b>

(a) Provisional Source : EPF Department, Central Bank of Sri Lanka

**(c) Payment of Interest on Member Balances**

A sum of Rs. 109.7 billion was available for distribution as interest to the members of the Fund as at end 2012, compared to Rs. 105.2 billion in 2011 (Table II-9). After transferring Rs. 5.7 billion from the reserves, the Fund was able to allocate an interest rate of 11.5 per cent on member balances in 2012 (Table II-10).

**Table II -9 Payment of Interest to Members**

Item	Amount (Rs.mn.)		Change (%)
	2011	2012(a)	
Gross Revenue	116,043	121,413	4.6
Total operating expenses	(786)	(948)	20.6
Income tax	(8,055)	(8,637)	7.2
Net income available for distribution	107,496	111,828	4.0
Interest paid on current refunds	(2,343)	(2,098)	(10.5)
Net income available for distribution (after payment of interest on current refunds)	105,153	109,730	4.3
Transfers from /(to) reserves	(3,500)	5,700	262.8
Net income available for distribution after transferring from / (to) reserves	101,653	115,799	8.3
Interest paid on member balances	(101,284)	(115,771)	12.5
Carried forward balance	369	28	(92.4)
Interest rate paid on member balances %	11.5	11.5	-

(a) Provisional Source : EPF Department, Central Bank of Sri Lanka

**Table II -10 Rate at which Interest was Paid on Member Balances**

Year	Interest Rate Paid (%)	Effective Interest Rate (%)
2002	12.10	12.26
2003	12.00	12.07
2004	9.50	9.59
2005	9.00	9.13
2006	10.10	10.30
2007	11.20	11.40
2008	13.20	13.44
2009	13.75	13.92
2010	12.50	12.65
2011	11.50	11.58
2012 (a)	11.50	11.62

(a) Provisional Source : EPF Department, Central Bank of Sri Lanka

### 8.3 Member Services

#### (a) Member Account Statements

Member account statements for the first half of 2012 will be issued to members through their employers during

March 2013. Arrangements will also be made to issue account statements for the second half of 2012 by end of August 2013.

#### (b) Housing Loan Facility

The Housing Loan Scheme, introduced in 1998 with the objective of facilitating the members to obtain housing loans from participating lending institutions, viz., HDFC Bank, State Mortgage and Investment Bank, National Housing Development Authority, Bank of Ceylon, Peoples Bank and Co-operative Rural Banks continued in 2012 as well. EPF continued to issue certificates of guarantees to members against their EPF balances under this scheme. During the year, 11,234 member balance certificates were issued to participating lending institutions for the approval of housing loans amounting to Rs. 3,973 million (Table II-11). Further, nearly Rs. 2,019 million was deducted from relevant member accounts and was remitted to the participating lending institutions in 2012 to settle loans in arrears during 2011.

**Table II -11 Housing Loan Facility**

Year	Certificates Issued (No.)	Credit Approved (Rs. mn.)	Amount Remitted to Lending Institutions (Rs. mn.)
2000	12,938	1,648	262
2001	16,066	2,091	381
2002	19,502	2,673	541
2003	18,689	2,792	670
2004	14,307	2,452	735
2005	14,600	2,766	900
2006	15,136	3,049	1,078
2007	12,969	2,872	1,240
2008	12,519	3,008	1,192
2009	10,383	2,680	1,552
2010	13,848	4,512	2,093
2011	20,041	6,355	1,896
2012(a)	11,234	3,973	2,019
<b>Total</b>	<b>192,232</b>	<b>40,871</b>	<b>14,559</b>

(a) Provisional Source : EPF Department, Central Bank of Sri Lanka

#### (c) Public Awareness

Awareness through networking was given prominence by the Department during 2012. The awareness programmes were mainly conducted at organizations with large numbers of members/employees registered with EPF. Further, different categories of stakeholders; members, employers, job market entrants, labour officials, rural bank officials and the general public were also addressed to improve their awareness on EPF related matters.

In 2012, twelve mobile services were conducted for employers at different geographical locations. These mobile services were held at Henfold Estate, Kurunegala Municipal Council, Udunuwara A.G.A division, Moratuwa-Medical & Communal Hospitality Day, Colombo-HR Service Providers Exhibition, Kurunegala Unichela Pvt. Limited, Meddacombra Estate of Elpitiya Plantations PLC-Colombo, MAS Slimtex, Katunayake Active Trading Pvt.Ltd. and Mega Career & Trade Fair in Hatton.

Mobile services were organized in collaboration with other relevant organizations such as the Department of Labour, Department of Registration of Persons, Registrar Generals' Department and Police Department. Accordingly, the following services were delivered through the mobile services:

- (i) Issuing of EPF balance statements to members
- (ii) Name and National Identity Card (NIC) number amendments of members
- (iii) Re-registration of members
- (iv) Promoting of member registration for SMS & Internet facilities
- (v) Counselling of members
- (vi) Issuing of applications for EPF members to obtain NICs by officers of Department of Registration of Persons
- (vii) Issuing of applications for EPF members to obtain Birth Certificates/Presumptive Age Certificates by the Registrar General's Department

#### **(d) e-Return System for EPF Payments**

The EPF Department has introduced a new system for employers to submit member contribution details electronically (e>Returns) as a replacement for the manual payment system (C & C3 returns). Submission of e>Returns, a total paperless solution, minimise the difficulties currently faced by both the EPF Department and the employers. The system had been continued with the initiative and the voluntary participation of employers upto 2012. In 2012, legal provisions to legalize this system had been approved through the amendments introduced to EPF Act by the Employees' Provident Fund (amendment) Act No.2 of 2012.

A Direct Debit Payment Scheme has also been introduced for employers enabling to transfer the monthly contribution directly from their bank to the EPF's bank account.

The EPF Department conducted 12 awareness campaigns and workshops on e-Return system for employers during 2012. As a result, registered number of employers with the system has increased to 1,385 in 2012 from 1,098 in 2011.

The EPF Department took steps to obtain the services of commercial banks by appointing them as collecting agents under this scheme. Accordingly, the Commercial Bank of Ceylon PLC and Bank of Ceylon provided the services to their customers with effect from October 2011

and September 2012, respectively. By end 2012, a total of 235 employers were enjoying the benefit under this facility. Further, Sampath Bank PLC, People's Bank and Hatton National Bank PLC are working on initiating the required IT systems to provide a similar service to their customers.

#### **(e) Re-registration of EPF Members**

Re-registration of EPF members is one of the key projects launched jointly by the EPF Department and the Department of Labour to re-register EPF members by names as appearing in their National Identity Cards (NICs) and assign NIC number as the Unique Identification (UID) Number which enables both institutions to use a common database for maintenance of the member accounts. Accordingly, EPF database will transform in to a Member Centric Database (MCD) from Employer Centric Database.

Re-registering of active EPF members (contributing members), has been completed by collecting NIC information of approximately 1.2 million members as at end 2012. 79 per cent of these members were assigned UIDs, while the balance is being processed after obtaining verification from their employers, as discrepancies between collected data and the existing data were observed.

Registering of new EPF members under NIC information on real time basis was commenced in November, 2010 and was carried out during the year 2012 as well. Accordingly, 40,000 new EPF members were registered and updated to the New Member Registry (NMR) during the year. A monthly monitoring system has been carried out to capture NIC information of all new members to whom member contributions are received by the EPF for the first time in each month.

Linking of previous member accounts of active members to UIDs was carried out during the year 2012. Accordingly, a total of 6,000 previous member accounts were linked to UIDs in the year. This facility provides a value addition for members to access and view their EPF balances of multiple accounts by providing their NIC numbers through Internet and Short Message System (SMS).

In 2012, a mechanism was proposed to re-register non-contributing EPF members according to their NIC information with the consent of the Commissioner General of Labour. This proposed scheme is scheduled to commence during the first half of 2013 as a pilot project with subsequent implementation.

#### **(f) The Image Scanning Project**

EPF is in the process of converting its operations in to a near-paperless environment. The Image Scanning Project (ISP) was initiated with the above objective in mind. ISP is expected to enhance the operational efficiency of the EPF Department by minimizing the time, space, cost, human resources and be supportive in achieving the objectives of other on-going projects.



The main tasks of the project are:

- (i) Scanning of existing documents (master files/Form D/Form RR6/NIC copy)
- (ii) Supply, installation, integrating and commissioning of an integrated Document Management System (DMS) for storage and retrieval of scanned images
- (iii) Linking of scanned images and the DMS with the existing EPF information system
- (iv) Installation of required Information & Communication Technology (ICT) infrastructure for future scanning of Form C/C3, Form D, Form RR6 and NIC copy at the point of reception

The project is planned to commence in the first quarter of 2013.

## 9. EXCHANGE CONTROL

The Exchange Control Department (ECD) was established in the CBSL on September 01, 1950. It continued to discharge the responsibilities entrusted to it under the Exchange Control Act (ECA) No 24 of 1953. The key functions of ECD are implementation of policies under the provisions of the ECA on foreign exchange transactions in the interest of the economy through issuance of Directions to Authorized Dealers (ADs) and issuance of Gazette Notifications, granting permissions and licenses on specific foreign transactions, surveillance on various foreign exchange transactions, investigations into violations of the provisions of the ECA. As in the recent past, in 2012, all these functions were focused on further relaxation of foreign exchange transactions in line with the current macroeconomic policy stance to promote competitive advantages of Sri Lanka in global business activities. These activities are essential for securing a high growth momentum in Sri Lanka.

Directions and Gazette Notifications issued in 2012 are given in Part III of the Annual Report.

### 9.1 Issuance of Directions

The ECD issued twelve new Directions to ADs during 2012 as summarized below.

- (a) **Forward Sales and Purchases of Foreign Exchange:** Permitting forward contracts for the sale and/or purchase of foreign exchange only for a maximum period of 90 days.
- (b) **Payments for Foreign Exchange Trading:** Not permitting payments for foreign exchange trading through electronic fund transfer cards or by any other mode of payments.
- (c) **Loans in Rupees to Sri Lankans Employed Abroad:** Permitting ADs to grant loans in Sri Lanka Rupees to Sri Lankans employed abroad to be utilized for any purpose in Sri Lanka.
- (d) **Inward Remittances Distribution Account (IRDA):** Permitting "Inward Remittances Distribution Account (IRDA)" to be used as a clearing account to disburse earnings of persons of providing services

abroad in seagoing vessels/ships and commercial aircrafts and those who are providing construction, janitorial, health, security, accounting, legal services etc. in foreign countries.

### (e) Foreign Exchange Earners' Account (FEEA):

(i) Permitting a single foreign currency account named "Foreign Exchange Earners' Account (FEEA)", combining several existing foreign currency accounts schemes permitted for foreign exchange earners such as exporters, indirect exporters, suppliers of inputs, professional services providers, entrepot traders, gem and jewellery dealers, insurers, insurance brokers, travel agents, hoteliers, bunker suppliers and other residents who undertake foreign projects.

(ii) Permitting credits to FEEA with funds transferred from IRDA.

### (f) Non-Resident Foreign Currency (NRFC) Accounts:

Amending the relevant Directions to permit debits to NRFC accounts freely.

(g) **Daily foreign exchange rates offered to Authorized Money Changers:** Requiring ADs to inform the Controller of Exchange on each working day, the maximum exchange rate offered to authorized money changers for each of the designated foreign currencies for deposits or sales of such currencies.

(h) **Issuance and Renewal of Bank Guarantees:** Amending the Direction on issuance and renewal of bank guarantees to cover different guarantee categories.

### (i) Non-Resident Foreign Currency (NRFC) and Resident Foreign Currency (RFC) Accounts:

(i) Permitting the fund transfers between NRFC accounts, between RFC accounts and from NRFC accounts to RFC accounts.

(ii) Permitting credits to NRFC or RFC accounts with funds transferred from IRDA.

### 9.2 Issuance of Gazette Notifications

The ECD issued two new Gazette Notifications during 2012.

- (a) **Increase the limit of Export and Import of Sri Lanka Currency (Gazette No. 1774/33 dated 07th September, 2012):** Increasing the limit of Rs. 5,000/- per person permitted for export/import by a citizen of Sri Lanka or a person resident in Sri Lanka on his person or in his baggage to Rs. 20,000/-.
- (b) **Permission to make payments in foreign currency using an Electronic Fund Transfer Card (EFTC) (Gazette No. 1789/34 dated 20th December, 2012):** Amending the permission granted to make payments in foreign exchange to a person resident outside Sri Lanka on his EFTC.

### 9.3 Approvals/Permits

The ECD granted 42 approvals and 75 permits for transactions falling under the provisions of the ECA as summarized below.

#### (a) Approvals

- (i) Received 25 requests from resident companies seeking special permission for overseas investments and granted permission to 14 companies to invest USD 65.68 million. 1 request was rejected and 10 requests are in the process of finalization.
- (ii) Received 37 requests from resident companies to borrow from abroad and granted permission to 28 companies to borrow a sum of USD 412.89 million. 4 requests were rejected and 5 requests are in the process of finalization.

#### (b) Issuance of Permits / Licenses

- (i) 10 new money changing permits were issued and the total number of authorized money changers increased to 84 from 82.
- (ii) 2 money changers who were successful in purchasing foreign currency over USD 4 million per annum were granted permission to sell foreign currency.
- (iii) 75 new companies were registered as freight forwarders, increasing the total number of freight forwarders to 504.
- (iv) 65 new permits were issued to other restricted dealers, such as duty free shops, tourists' hotels/restaurants, gem and jewellery shops and travel agents to accept payments in foreign currency for sale of goods and services to foreign parties and the total number of such restricted dealers was 765.

### 9.4 Surveillance and Investigations

- (a) 99 investigations were conducted during the year 2012 on non compliance with exchange control regulations. A sum of Rs. 14,171,853.03 was collected as the penalties on such violations. Most of the investigations related to unauthorized payments by residents to non-residents, violations of the conditions of the permits by restricted dealers and issue and transfer of securities contravening the procedure set out in the general permissions.
- (b) The ECD monitored a large number of foreign exchange transactions reported periodically by the ADs and other permit holders under relevant regulation to assess or identify possible violations and any possibility of unhealthy foreign exchange flows between Sri Lanka and foreign countries. This monitoring facilitated several policy measures and investigations to address such instances.

### 9.5 Public Awareness

With a view to enhancing the knowledge on current foreign exchange policies and recent relaxations of transactions of capital nature, awareness programmes were conducted for financial institutions, law enforcement authorities, government departments as well as the general public. Several regional seminars were also conducted with the collaboration of Provincial Offices of Central Bank. Thirty one awareness programmes were conducted during the year 2012.

## 10. FACILITIES MANAGEMENT

In view of the transformation of the Department's scope of work from traditional service provider activities to facilities management, the name of the Premises Department was changed as the Facilities Management Department (FMD) with effect from 01.01.2012.

During the year, 2012 FMD ensured operational reliability of critical services and a pleasing and comfortable working environment for the staff to work towards achieving the objectives of the Central Bank of Sri Lanka (CBSL).

In line with the Strategic Plan for 2012, FMD continued to carry out its primary functions aiming to achieve its goals including the maintenance and up-keeping of the Bank's premises and maintenance of a high degree of operational reliability of all critical services such as supplying of the logistic facilities, electricity, air conditioning, water supply, transport and communication. FMD could improve the reliability of the electricity power supply of the Centre for Banking Studies (CBS) at Rajagiriya by installing a new standby generator. The Department was able to achieve almost 100 per cent reliability in providing those facilities contributing to ensure business continuity of the Bank. Further, FMD was able to provide "Value for Money" for services provided by the Department through efficiency, cost effectiveness and timely delivery through a mechanism of professional evaluation of projects, selection of cost effective and high standard contractors and close monitoring of project progress to ensure completion by agreed time targets with the required standards. FMD also plans to upgrade the existing Integrated Security System installed at the CBSL Head Office, and replace the existing turnstiles with modern flap type barriers. The procurement process of this project was finalised by the end of 2012.

During the year, FMD undertook several refurbishment projects and new construction projects, namely, Construction of a Multi-storey Car Park, additional apartment for the Kataragama Holiday Home, Northern Provincial Office in Kilinochchi and Disaster Recovery Site at Rajagiriya. The refurbishment work of the Central Point Building formerly named National Mutual Assurance Building, which is a 100 year old colonial building acquired by CBSL was carried out and most

work was completed by end 2012. Refurbishment work is expected to be completed early 2013.

CBSL purchased "Whiteaways Building" which is also a colonial building built about 100 years ago with the view of renovating within the year 2013 to restore the appearance of this historic building to its original glory. Procurement of the Whiteaways Building was also completed and renovation work commenced in December 2012.

FMD finalized preliminary considerations for constructing a building complex in Kilinochchi to house the Northern Provincial Office of CBSL with the view to facilitate the expediting the development activities in all administrative districts in the Province by promoting development finance, banking and financial activities and public awareness in related activities. FMD commenced the project to construct a nine-storey car park at its Head Office premises in the fourth quarter of 2012, to meet parking requirements of the Bank and the staff and is expected to complete the project in 2013.

In 2012, FMD strengthened its fleet of vehicles by purchasing new vehicles and improving the conditions of the vehicles to mitigate operational risk. The Department was able to provide transport facilities for a number of international conferences sponsored by CBSL in addition to normal functions of the Bank. Also, an effective shuttle service between the CBSL Head Office and CBSL car park at the Chalmers Granary Land was provided by the FMD after the car park at the Transworks Square was shifted to the Chalmers Granary Land. Further, facilities were provided for several religious functions, welfare activities and events with national interest.

## 11. FINANCE

The Finance Department (FD) which was established in 2002 undertakes the financial reporting function of the Central Bank of Sri Lanka as per the decisions of the Monetary Board, applicable accounting standards and provisions of the Monetary Law Act (MLA). This function covers the preparation of the financial statements, preparation and monitoring of the annual budget, maintaining a timely and error free payment system for internal and external financial transactions, management of several internal funds, maintaining Fixed Assets Register and maintaining the data base of staff loans. Audited Financial Statements of the Central Bank compiled by the FD for the year 2012 are given at the beginning of this section of the Annual Report.

### 11.1 Preparation of the Financial Statements

(a) **Monthly Balance Sheet:** As per the requirement of the Monetary Law Act, the monthly Balance Sheets were prepared and published in the Government Gazette of the following month during the year 2012.

(b) **Annual financial statements:** International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS) have been adopted for this purpose since 2003. These statements are published in the Annual Report of the Central Bank. The FD updated accounting systems and procedures to comply with these standards and statutes and their disclosure requirements on a continuous basis during the year 2012.

### 11.2 Preparation of the Annual Budget and the Activity Base Budget

The annual income and expenditure budget and capital budget of the CBSL for the year 2013 were prepared in line with action plans under the strategic plans of each Department of the Central Bank. The activity-base and functional budget was also prepared along with this budget to show the activity-wise cost of Departments and function-wise cost of the Central Bank. This process was started in August 2012 and was finalised in December 2012. The approval of the Monetary Board was obtained in December 2012 and the budget was made available to the Departments on the first day of 2013. Quarterly budgetary performance statements for the year 2012 were submitted to Departments and the Monetary Board in the interest of effective monitoring of budgetary control.

### 11.3 Payment System for Internal and External Financial Transactions

- (a) All internal payments for employee remunerations, staff loans, operational expenses, etc., were made in 2012 accurately within the time targets.
- (b) All external payments to local and foreign suppliers were made as per the procedures of the Central Bank. During the year 2012, 4,563 and 262 payments were made to local and foreign suppliers, respectively.
- (c) Nearly 2,722 disbursements to the General Treasury and relevant projects and 1,035 repayments of Foreign loans were made during the year 2012. Month-end statements for 2012 were issued to the General Treasury and projects as requested.

### 11.4 Management of Internal Funds

FD managed 12 internal funds which cover 6 superannuation funds of the staff and pensioners, 3 medical benefit funds and 3 special funds. Managing cash flows, investments of funds, making settlements and payments, keeping books of accounts and preparing annual financial statements are the major functions in this regard. The funds are invested in government securities and the average yield rate was 11.66% for the year 2012. The audited financial statements of these funds for 2011 were submitted in 2012 to the Monetary Board as per the rules of those funds.

**Table II - 12** Performance of Internally Managed Funds - 2012

Funds	Inflows	Out flows	Investments	Investments Year-end	Rs. mn Average Yield (% p.a.)
Superannuation funds	11,509.1	3,296.6	8,212.5	34,246.6	11.52
Medical funds	31.0	1.0	30.0	93.9	12.26
Special funds	657.0	13.9	643.1	1,141.2	12.63
<b>Total</b>	<b>12,197.1</b>	<b>3,311.5</b>	<b>8,885.6</b>	<b>35,481.7</b>	<b>11.66</b>

### 11.5 Maintaining the Fixed Assets Register

The FD maintained the Fixed Assets Register in the fixed asset module of the General Ledger System. All changes such as new purchases and locations, changing of locations, revaluations, depreciation and disposals were recorded in this register during the year 2012. Nearly 693 changes were incorporated to the Register in 2012.

### 11.6 Maintaining the Data Base of Staff Loans

The FD continuously maintained the loan data base of Central Bank staff with the assistance of the Information Technology Department to facilitate recovery process of loans and provide information to the employees and to the Management during the year 2012.

### 11.7 Other Operations

#### (a) Procurement Process

According to the Rules of the Central Bank, the officers of the Finance Department attended all Technical Evaluation Committees and Tender Boards for procurement of goods and services and the Board of Survey carried out by the Secretariat Department during the year 2012. Nearly 261 Tender Boards meetings were attended during the year 2012.

#### (b) New GL System

The Central Bank has been using the Oracle General Ledger System for its accounting function since the year 2003 and is now in the process of developing in-house a General Ledger System to be launched with effect from 01.01.2014. The Information Technology Department is developing this new GL System and the Finance Department is involved in updating the chart of accounts and assists continuously to the Information Technology Department.

#### (c) Investment Oversight Committee

The role of the Investment Oversight Committee established by the Monetary Board is to advise and monitor the investments of funds managed by several Departments of the Central Bank. This

committee meets monthly and the FD provides secretariat service for the monthly meeting of this committee with the Heads and other officers of the respective Departments. The Committee had 12 meetings during the year 2012 and submitted papers quarterly to the Monetary Board.

## 12. FINANCIAL INTELLIGENCE UNIT

The Financial Intelligence Unit (FIU) has been established in terms of the provision of the Financial Transactions Reporting Act No 6 of 2006 (FTRA) and operating in the Central Bank of Sri Lanka since 2007. The key functions of the FIU include collection and receipt of information on financial transactions for the purpose of detecting possible links to Money Laundering (ML), Terrorist Financing (TF) and other unlawful activities defined in the FTRA, investigations into suspicious financial transactions relating to the above and dissemination of information and details of such investigation to relevant law enforcement and regulatory authorities for appropriate actions and conduct of examination of reporting institutions. The highlights of key functions and other activities of the FIU during 2012 as stipulated in the FTRA were as follows.

### 12.1 Collection of Information, Investigations and Dissemination

Licensed Commercial Banks (LCBs), Licensed Specialised Banks (LSBs), Licensed Finance Companies (LFCs), Stock Broking Firms (SBs) and Insurance Companies (ICs) continued to report to the FIU on cash transactions and electronic funds transfers (both local and foreign) of Rs. 1.0 million and above or its equivalent in foreign currencies through the FIU's on-line database management system, "LankaFIN". Accordingly, over 3.9 million of cash/fund transfers and 559 suspicious transactions (STRs) were reported during the year 2012. After conducting preliminary investigations, 56 STRs were referred to the law enforcement and regulatory authorities for further investigation. Based on the investigations conducted by the Criminal Investigations Department (CID), the Attorney General's Department has so far filed seven indictments against money laundering and three indictments against terrorist financing including four indictments that were filed in 2012.

### 12.2 Examinations of Reporting Institutions

During the year 2012, FIU conducted sixteen examinations on reporting institutions covering all sectors, to assess their exposure to risk of ML and TF and non-compliances with the provision of FTRA and other rules and directions issued by the FIU.

### 12.3 Other Activities

#### (a) Signing of Memorandums of Understanding

As a mechanism to facilitate sharing of information and intelligence for the purpose of investigation and prosecution of suspicious transactions, in

terms of provisions of the FTRA, the FIU signed four Memorandums of Understanding (MOUs) with Financial Crime Enforcement Network (FinCen) of USA, The Financial Information Unit of the Bank of Mongolia, Federal Financial Monitoring Service of Russian Federation and Saudi Arabian Financial Investigation Unit. Accordingly, the total number of such MOUs signed increased to 20 as at end of 2012.

**(b) Improvement in the Regulatory Framework**

In February 2012, the Financial Action Task Force (FATF), the Global Anti Money Laundering (AML) and Countering the Financing of Terrorism (CFT) standards and policy setter has re-classified 40+9 recommendations into 40 recommendations and widened their scope to include the financing of the proliferation of weapons of mass destruction in addition to money laundering and terrorist financing. Such proliferation is identified as a most serious security concern globally and, therefore, the FATF has adopted a new recommendation (recommendation 7 under the revised FATF recommendations) aimed at ensuring effective implementation of sanctions declared by the United Nations Security Council (UNSC). With the view to further strengthening the financial regulatory framework in Sri Lanka in line with the changes in such international standards and best practices on national level, the Advisory Committee for the FIU formed a legal review committee, comprising relevant authorities to revise FTRA to strengthen the operations of the FIU. Further, the FIU was in the process of finalizing rules to be issued to Authorized Money Changing Companies in relation to Know-Your-Customer and Customer-Due-Diligence (KYC/CDD) requirements and has planned to issue such rules during 2013.

**(c) Institutional Capacity Building and Awareness Programmes**

In continued efforts to enhance the awareness on detecting, analyzing and reporting of money laundering and terrorist financing transactions, 28 awareness/training programmes were conducted during the year, accommodating more than 1825 participants from LCBs, LSBs, LFCs, Sri Lanka Police, educational and public institutions. Two such programmes were conducted with the assistance from the AUSTRAC, Australian FIU.

**(d) International Relations**

- (i) Egmont Group :** The FIU obtained assistance from members of the Egmont Group, the Association of FIUs consisting of 132 FIUs globally to carry out investigations and collaborated with member countries for gathering evidence on their investigations. The total number of instances that FIU exchanged information with foreign Egmont members was 23 in the year 2012.

- (ii) Asia Pacific Group on Money Laundering :** Sri Lanka, as a founder member of the Asia Pacific Group on Money Laundering (APG), attended its 15th Annual Meeting held in Australia in July 2012 and the 15th Annual Typologies and Capacity Building Workshop held in Vietnam in November 2012 focusing on vulnerabilities in cash courier services and trade based money laundering.

### 13. FINANCIAL STABILITY STUDIES

Maintaining financial system stability is one of the two core objectives of the Central Bank as per the Monetary Law Act. The Financial Stability Studies Department (FSSD) facilitates this objective by its research and surveillance functions.

The main functions of the FSSD are to conduct research in the financial stability area, assess risks and vulnerabilities in the financial system through a macro-prudential surveillance framework, propose appropriate policy measures based on such research and surveillance and create awareness of financial stability among policy makers and stakeholders.

#### 13.1 Activities during the Year

**(a) Research**

Several research studies were carried out during 2012. The main studies were on credit growth and the determinants of banking sector profitability.

**(b) Macro-Prudential Surveillance**

- (i) Financial Soundness Indicators were compiled for the banking, non-bank and corporate sectors on a periodic basis to monitor the health of key financial and non-financial institutions.
- (ii) Financial Sector Risk Assessment Reports highlighting developments, risks and vulnerabilities in all relevant sectors were submitted to the Financial Systems Stability Committee, (FSSC) regularly.
- (iii) The Banking Soundness Index (BSI) was improved incorporating a sub indicator for corporate governance of the banking sector. BSI was updated on a quarterly basis.
- (iv) The Financial Market Stability Indicator (FMSI) to assess the stability in the money and bond, equity and forex markets was improved after testing the relevance of the variables. This indicator was updated on a monthly basis.
- (v) A new Macro-economic Stability Indicator (MESI) was constructed to assess the stability in macro economic sectors such as fiscal, real, monetary and external sectors as well as the global environment. MESI was updated on a quarterly basis.

- (vi) Using the BSI, FMSI and MESI indicators, a composite indicator named Financial Systems Stability Indicator (FSSI) was constructed to provide an overall picture of financial stability in the country.
- (vii) The Corporate Sector Credit Worthiness Indicator which analyzes the credit worthiness of the corporate sector in Sri Lanka by assessing the probability of default of companies listed on the Colombo Stock Exchange was updated on a quarterly basis.

#### (c) Publications

The annual Financial System Stability Review (FSSR) 2011 was published in March 2012. FSSR 2012 was prepared in the last quarter of 2012 and will be published in the first quarter of 2013.

#### (d) Coordination of the Committees on Financial System Stability

FSSD continued to serve as the secretariat for the two financial stability committees, namely, FSSC, the internal committee and the Financial Systems Stability Consultative Committee (FSSCC) consisting of persons from the private sector.

### 13.2 Contribution

#### (a) Awareness Creation

Through its publications related to financial system stability, FSSD has contributed toward creating awareness among the stakeholders of the financial sector and the public of the status of the financial system of the country, highlighting factors that have contributed to stability and factors that need to be closely monitored to ensure stability is maintained.

#### (b) Facilitating Financial Sector Risk Mitigation

- (i) Considering the implications of the new financial reporting standards on financial sector, the preparedness of financial institutions to adopt these was assessed.
- (ii) Due to the rapid growth in the regulated pawning sector, a survey has been initiated to assess the size of the unregulated pawning sector.
- (iii) Discussions have been initiated with relevant institutions to formulate a system to minimize irregularities in valuations used for financial reporting in financial institutions.

#### (c) Facilitating Financial Market Development

- (i) Proposals outlining measures to fast track the development of the corporate debt market and issue of corporate debt in foreign currency were submitted to the relevant authorities. Several of these measures have been already introduced by the Budget of 2013.
- (ii) Proposals were submitted for the improvement of the new section on "Rehabilitation and Revival of Companies" to be incorporated in the Companies Act No.7 of 2007.

### 14. GOVERNOR'S SECRETARIAT

During the year, the Governor's Secretariat (GSD) delivered extensive operational and technical assistance required by the Governor, in a challenging and ever changing financial and economic landscape.

GSD performed its multi-tasks in a setting that was aligned to the ambitious economic goals of the Sri Lankan economy. GSD engaged in providing top quality secretarial, administrative assistance and protocol services for the Governor while having effective interactions with global and local partners in the sphere of banking, finance and economic segments. In this regard, the management of time, information, communication and relationships were the major thrusts of the GSD, that were handled with due care and professionalism.

GSD implemented a planned approach ensuring proper time management for the Governor, by scheduling the Governor's appointments smoothly, while coordinating a large number of such appointments and follow-up with relevant parties. GSD also extended the required secretarial assistance to the Governor by drafting and processing necessary documents including presentations, speeches, keynote addresses, notes, correspondence, etc.

GSD acquired and maintained a thorough understanding of operations of the bank as well as all other correspondence of the Governor, and assisted to build a strong bridge of communication for the Governor. GSD also communicated the important information that closely impacted the operations of the Bank in a manner that would serve the best interests of the Bank. GSD also handled incoming and outgoing telephone calls for the Governor with high courtesy and assisted the public on a daily basis by responding promptly to any queries directed to the Governor. In addition, GSD handled incoming and outgoing postal mails, e-mails and other correspondence and presented such information in a suitably summarized form to the Governor and responded to such mails in the appropriate manner. At the same time, GSD closely followed up the instructions issued by the Governor to ensure that the entrusted tasks were carried out in time. Moreover, GSD carried out many important and urgent activities which needed to be given high priority.

GSD functioned in close cooperation with the senior management of the Bank and other relevant outside institutions. The relationship management of the Governor's Secretariat involved international dimensions in order to place Sri Lanka's financial and economic reputation at a high level which helped to build investor confidence in the country. In this context, interacting with investors, providing them with necessary information and by arranging required meetings with the Governor, arranging tele-conferences and tele-interviews for the Governor with foreign investors and foreign media, were activities that were carried out efficiently and effectively, almost on a daily basis.

Protocol functions were handled round the clock ensuring the credibility and reputation of the Governor and the Monetary Board. In this regard, GSD also

provided necessary protocol services for the Governor, Deputy Governors, VIP visitors to the Governor and VIP invitees to the Bank. High courtesy maintained by the Governor's Secretariat in performing protocol functions helped to build the image of the CBSL.

All arrangements for local and foreign travel of the Governor were made by GSD. The Governor made many field visits to a number of places of economic significance and attended a number of official functions for which the necessary arrangements together with other protocol services were arranged. The Governor also made a number of official visits abroad to attend high-level international symposiums, investor road shows and meetings, and other official meetings, in addition to participating in state visits. In this regard, GSD assisted the Governor by providing necessary information, reports and presentations in order to ensure the success of these events and interactions. All official functions hosted by the Governor and Deputy Governors were also arranged by GSD.

## 15. HUMAN RESOURCES MANAGEMENT

The mandate of the Human Resources Department is to develop human resources management policies and adopt best practices to enable the CBSL to attract and

retain the best talents, ensuring realization of the true potential of the individuals and adding value to the delivery of services, enabling the CBSL to accomplish its mission to realize its vision. The strategic objective of HRD focused on ensuring the availability of highly productive, motivated and contended team of employees in the Bank, who contribute towards achieving the Bank's core objectives amidst emerging challenges. In achieving its strategic objective, the key functions performed by HRD are training and development, performance management, succession planning and promotions, recruitment, job rotation and maintaining closer dialog with all internal stakeholders in line with the human resources needs identified in the Strategic Plan of the CBSL.

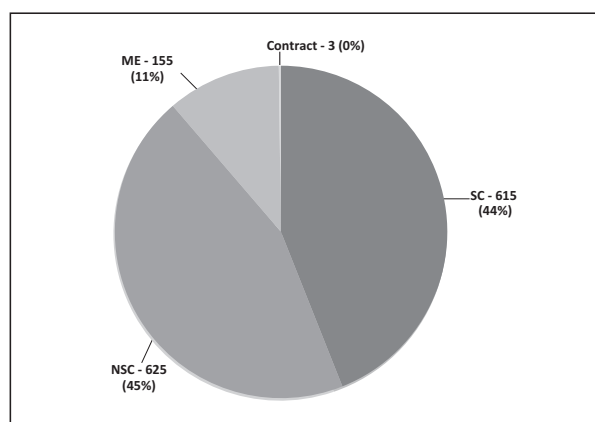
### 15.1 Human Resources Structure

As at the end of December 2012, the total human capital stood at 1,398 consisting of 615 Staff Class officers, 625 Non-Staff Class officers, 155 Minor Employees and 03 officers who are providing their services under fixed term contract. During the year, 33 Staff Class officers and 16 Non-Staff Class officers retired, while 11 employees resigned from Bank service.

Table II - 13

Human Resources Structure as at 31.12.2012

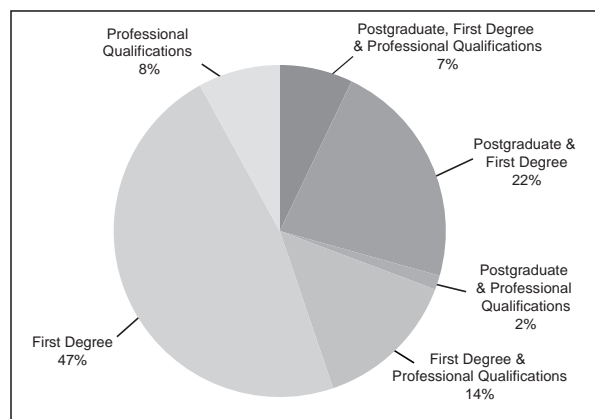
Categories of Employees	No. of Employees			Average Age	Educational/Professional Qualifications					
	Male	Female	Total		Postgraduate, First Degree & Professional Qualification	Post Graduate & First Degree	Postgraduate & Professional Qualification	First Degree & Professional Qualification	First Degree	Professional Qualification
(1) Staff Class										
(i) Grade IV & above	55	17	72	54	15	46	3	4	4	...
(ii) Grade III.2	50	10	60	53	6	36	...	1	16	...
(iii) Grade III.1	14	26	40	47	1	10	1	6	20	...
(iv) Grade II	75	84	159	44	11	19	2	21	70	4
(v) Grade I	108	176	284	41	5	17	1	44	118	22
(2) Non Staff Class										
(i) Grade V	39	29	68	56	...	...	...	...	4	2
(ii) Grade IV	80	41	121	50	...	...	...	...	12	2
(iii) Grade III	39	7	46	52	...	...	1	...	...	2
(iv) Grade II	157	130	287	32	...	...	...	7	28	13
(v) Grade I	96	7	103	44	...	...	...	...	...	...
(3) Minor Employee Class										
(i) Grade I, II and III	142	13	155	32	...	...	...	...	...	...
(4) Contractual Employees										
(i) All Categories	2	1	3	58	...	1	...	...	...	1
<b>Total</b>	<b>857</b>	<b>541</b>	<b>1,398</b>	<b>42</b>	<b>38</b>	<b>129</b>	<b>8</b>	<b>83</b>	<b>272</b>	<b>46</b>

**Chart II-3** Composition of the Staff as at 31.12.2012

As at December 31, 2012, the average age of an employee in the Bank was estimated at 42 years. Out of the total number of employees, 26 per cent was below 30 years, while 29 per cent was between the ages of 31 to 45. The percentage of young staff has increased substantially in recent years mainly due to recruitment of new staff.

The Bank consists of 27 departments and 5 provincial offices and each department and provincial office is staffed with qualified and competent officers who are capable of performing duties efficiently. Out of the total number of Staff Class officers, nearly 82 per cent had a first degree qualification, postgraduate degree or a professional qualification. As at end 2012, 9 officers had acquired PhD qualifications and 3 of them had acquired a professional qualification too.

As at end December 2012, the total number of officers who had acquired first degree, postgraduate degree and professional qualifications in subjects relevant to the CBSL was 576. The composition of the qualifications is shown in Chart II-4.

**Chart II-4** Composition of Qualification of the Staff

## 15.2 Functions of the HRD

### (a) Training and Development

Section 27 of the Monetary Law Act No.58 of 1949 empowered the CBSL to bear the cost of studies and training of Bank staff abroad or in Sri Lanka in the areas of economics, banking, statistics and other relevant subjects. Accordingly, during 2012, HRD continued to provide long term and short term foreign and local training opportunities for Bank staff, in order to improve knowledge of the staff on modern technical changes taking place in the global financial sector and to improve intellectual capacity of the staff.

#### (i) Short-term Training

In line with the training plan 2012, which was prepared based on the competency gaps identified through the annual competency mapping exercise carried out at the end of 2011, the HRD provided short-term foreign and local training opportunities to minimize the identified competency gaps of the Bank employees.

#### (ii) Short-term Foreign Training

Short-term foreign training opportunities were provided mainly at reputed institutions i.e. IMF, SEACEN Centre, Reserve Bank of India, Deutsche Bundes Bank etc. The total number of foreign training opportunities provided during 2012 increased by 4 per cent to 213, compared to 204 training opportunities provided in 2011. Table II -14 shows the details of the foreign training opportunities provided in 2012.

**Table II - 14** Short-term Foreign Training Opportunities - 2012

Field	No. of Participants
Economics	43
Financial Stability	56
Reserves Management	19
Public Debt Management/ Portfolio Management	25
Currency Management	10
IT and Payment Systems	12
Central Banking	12
Human Resources Management	10
Other	26
<b>Total</b>	<b>213</b>

The Training Sub-Committee (TSC) continued to assess value additions of short-term foreign training



by assigning the officers various projects to be carried out using the knowledge gained through the training programmes. During 2012, 111 such assignments were completed by the officers as directed by the TSC. Out of the 111 assignments 30 projects were implemented successfully, recording a significant increase of the value addition made through short-term foreign training, in comparison to that of the previous years. Such value additions were made mainly in the areas of issuing guidelines for supervision of financial institutions, making improvements for existing systems and processes, making public awareness and knowledge sharing etc. The details of the value additions and completion of assignments during 2012 are summarized in Table II -15 below.

**Table II - 15** Value Additions & Completion of Assignments by Participants of Short-term Foreign Training Programmes during 2012

Category	No. of Assignments
Guidelines for supervision of financial institutions	12
Designing of training programmes	5
Knowledge sharing & public awareness	28
Concept papers and country studies	40
Proposals for improving systems & processes	26
<b>Total</b>	<b>111</b>

### (iii) Short-term Local Training

In addition to the foreign training opportunities, a total of 1,530 short-term local training opportunities were also provided to the Bank staff mainly at the Centre for Banking Studies (CBS), the training arm of the Bank and other reputed institutes in the country, during the year. The number of officers who participated in training programmes conducted by CBS and other institutes were 900 and 318 respectively. In providing local training opportunities, priority was given to areas such as economics, bank supervision, financial and capital markets, microfinance, information technology, communication, internal auditing and management, enabling participants to update the knowledge and improve their performance.

### (iv) Workshops and Language Training Programmes

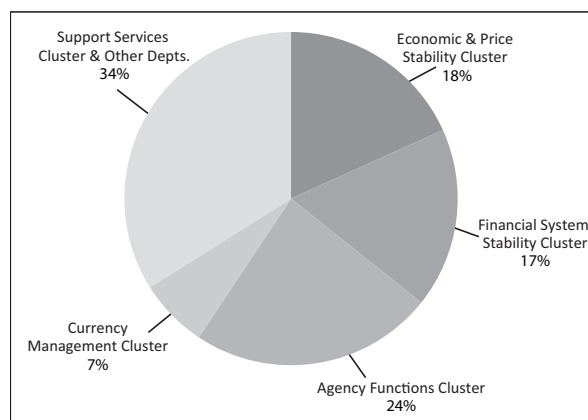
With the objective of enhancing soft skills and technical skills, which are important for Bank staff to excel in their career, HRD organized 11 workshops in 2012 covering areas such as leadership, motivation, communication and report writing. In addition, the HRD continued providing

Tamil language training in 2012 in collaboration with the Official Languages Department to facilitate the Bank staff to provide services to the Tamil speaking community, in a more efficient manner.

The distribution of short term foreign and local training opportunities provided in 2012 for the officers in the five clusters is shown in Chart II-5 below.

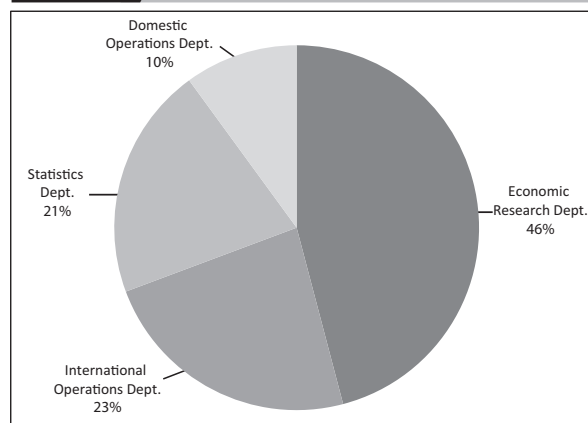
The share of the short-term training opportunities provided for the officers in the 8 departments in the economic & price stability cluster and the financial system stability cluster was 35 per cent.

**Chart II-5** Short-term Training Opportunities - 2012

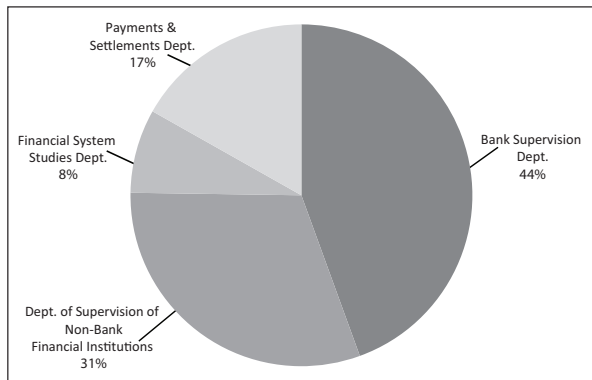


The Chart II-6 and II-7 below indicate the distribution of training opportunities among departments in economic & price stability cluster and the financial system stability cluster. Out of the total number of training opportunities for the economic and price stability cluster, 46 per cent was provided for the officers in the ERD. The majority of the training opportunities for the financial system stability cluster was attended by the officers in the BSD.

**Chart II-6** Economic & Price Stability Cluster



**Chart II-7 Financial System Stability Cluster**



In addition to the training facilities provided by HRD for Bank staff, several departments implemented their own knowledge sharing, skills development and research activities within the departments to improve the knowledge and skills of the employees such as establishment of Macroeconomic Modeling Unit by ERD to facilitate its officers to conduct comprehensive economic research.

**(v) Long-term Training**

Under the scholarships programme for postgraduate studies, which aims to improve intellectual capacity of the Staff Class officers, CBSL in 2012 sponsored 4 officers and 18 officers to pursue PhD programmes and MSc. programmes respectively, in reputed universities in the UK, USA, Canada, Australia and China. Out of the total 22 officers who commenced postgraduate studies, 16 officers are pursuing their studies in economics. Meanwhile, 2 officers and 17 officers resumed duties in the Bank upon successful completion of PhD programmes and MSc. programmes respectively, during the year. With the enhancement of intellectual capacity of the officers, the CBSL has been able to make more accurate policy decisions relating to economic and financial sectors. Table II – 16 below shows the details of the number of officers who pursued postgraduate studies under the CBSL scholarships programme during the period from 2008 to 2012.

**Table II - 16 Number of officers acquired postgraduate qualifications under CBSL Scholarships Programme**

Qualification	2008	2009	2010	2011	2012
MSc	9	2	6	10	17
PhD	-	1	2	2	2

**(b) Performance Management**

Performance management of the CBSL includes preparation of job descriptions and setting goals in line with the Strategic Plan, monitoring performance

on continuous basis, evaluation of performance and rewarding good performance. In the performance evaluation process, the level of performance of each employee is assessed assigning ratings for the performance, generic competencies and technical competencies as specified in the evaluation format. The final performance ratings are used as one of the criteria for granting promotions.

In 2012, HRD completed evaluation of performance of all employees for the year 2011 as scheduled in the Strategic Plan. The individual and departmental goal setting process for the year 2012 was also completed as per the time targets set out in the Strategic Plan.

With the aim of strengthening performance management further, in 2012, HRD introduced the mid-year performance review system which allowed supervisors and employees to obtain an indication on the performance during the first half of the year.

**(c) Succession Planning and Promotions**

Having recognised the critical importance of succession planning and filling vacancies in all key positions of the CBSL, HRD facilitated promoting four Heads of Departments to the post of Assistant Governor and 12 Staff Class Grade III officers to the post of Deputy Head of Department in 2012.

Under the promotion scheme for granting promotions from Non Staff Class to Staff Class, in 2012, 26 officers who were in Non Staff Class Grade IV and V were promoted to Staff Class Grade I. Further, 7 ME Grade III employees who had met the requirements of the applicable promotion criterion were promoted to Non Staff Class Grade I. 192 staff members were also granted grade promotions in accordance with the applicable promotion criteria.

**(d) Recruitment**

In 2012, HRD took measures to recruit a new batch of Management Trainees (MTT) to meet the competency requirements of the Bank through absorbing new knowledge and the best talents available in the job market. Under this, 74 external candidates and 8 internal candidates were recruited as MTT with effect from January, 1, 2013. In this recruitment, the HRD took measures to recruit 9 differently abled qualified candidates too as MTT, highlighting the necessity of giving equal employment opportunities for the differently abled community. 15 Assistant Security Officers were recruited to fill the vacancies which had arisen due to the retirement of security officers and the expansion of the activities of the Bank. Two technical officers from the fields of electronics/telecommunications and civil were also recruited to the Facilities Management Department (FMD) of the Bank to increase the efficiency of the services provided by the FMD.

**(e) Job Rotation**

As a measure of developing a multi skilled work force and enhancing overall productivity of the Bank, the HRD in 2012, continued to implement the annual job rotation scheme. Accordingly, 43 staff members who had completed 5 year service in the same department or in the same provincial office were rotated among 15 departments and 2 provincial offices of the Bank w.e.f. July, 1, 2012, taking into account the competency requirements of the departments and the qualifications and the competency levels of those employees.

**(f) Employer- Employee Relations**

In 2012, HRD continued to perform its role as the facilitator for maintaining a closer dialogue between the trade unions and the Management and facilitated for the trade unions to meet the Management to discuss issues as and when necessary. Accordingly, 12 discussions were arranged during the year. Such dialogs helped the Management to resolve a number of issues relating to remuneration, promotions, training, welfare, recruitment and general administration of the Bank for maintaining industrial peace. Further, the HRD was able to successfully negotiate with all trade unions of the Bank and finalize the signing of the collective agreement on the salary revision for the period 2012 - 2014.

**15.3 Training for Undergraduates and Students of the Institute of Chartered Accountants of Sri Lanka (ICASL)**

In addition to the contribution made for developing the human capital of the CBSL, HRD continued facilitating to build a high quality future work force in the country, through providing internships and accounts training for undergraduates and the students of ICASL, respectively.

**(a) Three Month Internship Programme for Undergraduates**

Through this internship programme, the CBSL has opened an avenue for Sri Lankan undergraduates to be familiar with the practical aspects of theoretical concepts learned at the universities in the areas of economics, finance, information technology, human resources management and law. This programme also facilitates students to obtain hands on experience in related departments of the Bank for a period of three months. In addition, the interns are able to improve their personality and professionalism, which are prerequisites for enhancing their employability in the job market. During the year 2012, in collaboration with the other departments, HRD conducted 4 internship programmes for 99 students selected from 14 local and the foreign universities and the Sri Lanka Law College.

**(b) Six Month Internship Programme for Undergraduates**

HRD signed a memorandum of understanding with the Faculty of Management Studies and Commerce of the University of Sri Jayawardenepura in order to facilitate

the final year undergraduates to fulfill their compulsory training component of the degree programmes at the EPF Department of the CBSL. Accordingly, 48 undergraduates were provided training opportunities for a period of six months commencing October, 3, 2012.

**(c) Accounts Training for Students of ICASL**

During 2012, HRD facilitated for 21 students of the ICASL to fulfill their compulsory study requirement by working as accounts trainees at the CBSL under the supervision of qualified and experienced Chartered Accountants.

**15.4 Meetings Attended by the Governor Abroad during the Year 2012**

1. Meetings with Government and business leaders with H E the President's delegation in Qatar and Dubai in January.
2. 47th SEACEN Governors' Conference and High Level Seminar and 31st meeting of the SEACEN Board of Governors in Korea and Courtesy Call on President and Prime Minister in Singapore in February.
3. Meetings with investors and bankers in Qatar in March.
4. IMF/WB Spring Meetings and investor meetings in USA and H E the President's delegation to attend business meetings in Korea in April.
5. Delivering the keynote address at the 6th SEACEN Advanced Leadership Course and attending SEACEN Governors' Symposium in Nepal in May.
6. Attending the Business Forum in Thailand and meetings with investors in the United Kingdom in June.
7. Meetings with investors in the United Kingdom in July.
8. Meetings with Government officials in Mauritius in August.
9. Investment Promotion Seminar in Japan in October.
10. 32nd SEACEN Board of Governors' meeting and 48th SEACEN Governors' Conference in Mongolia in November.

**15.5 Promotions / Appointments**

1. The following promotions and appointments were made effective from 01 January 2012.
  - (i) Mrs. R. Dheerasinghe was appointed as Assistant Governor
  - (ii) Mr. A. Kamalasinghe was appointed as Assistant Governor
  - (iii) Mr. K. D. Ranasinghe was appointed as Assistant Governor
  - (iv) Mr. S. S. Ratnayake was appointed as Assistant Governor

2. Mr. D. Wasantha, Director of the Policy Review and Monitoring Department, was appointed as Secretary of the Secretariat Department with effect from 01 January 2012.
3. Mrs. S. Gunaratna, Additional Director of the Economic Research Department, was appointed as Acting Director of the Economic Research Department with effect from 01 January 2012 and subsequently appointed as Director of the same department with effect from 01 July 2012.
4. Mrs. K. Gunatilleke, Additional Superintendent of the Employees' Provident Fund Department, was appointed as Acting Superintendent of the Employees' Provident Fund Department with effect from 01 January 2012 and subsequently appointed as Superintendent of the same department with effect from 01 July 2012.
5. Mr. N. W. G. R. D. Nanayakkara, Additional Director of the Bank Supervision Department, was appointed as Acting Superintendent of the Public Debt Department with effect from 01 January 2012 and subsequently appointed as Superintendent of the same department with effect from 01 July 2012.
6. Mr. P. W. D. N. R. Rodrigo, Additional Director of the Policy Review and Monitoring Department, was appointed as Acting Director of the Policy Review and Monitoring Department with effect from 01 January 2012 and subsequently appointed as Director of the same department with effect from 01 July 2012.
7. Mr. J. P. R. Karunaratne, Additional Superintendent of the Public Debt Department, was appointed as Additional Director of the Bank Supervision Department with effect from 01 January 2012 and subsequently appointed as Acting Superintendent of the Currency Department with effect from 03 September 2012.
8. Mrs. U. L. Muthugala, Acting Additional Director of the International Operations Department, was appointed as Acting Additional Superintendent of the Public Debt Department with effect from 01 January 2012 and subsequently appointed as Additional Superintendent of the same department with effect from 13 June 2012.
9. Mrs. K. M. A. N. Daulagala, Director of the Supervision of Non-Bank Financial Institutions Department, was appointed as Director of the Financial Stability Studies Department with effect from 02 April 2012.
10. Mr. E. A. Hettiarachchi, Director of the Statistics Department, was appointed as Director of the Welfare Department with effect from 02 April 2012.
11. Miss. K. Saravanamuttu, Director of the Financial Stability Studies Department, was appointed as Director of the Statistics Department with effect from 02 April 2012.
12. Mr. H. M. Ekanayake, Additional Director of the Supervision of Non-Bank Financial Institutions Department, was appointed as Acting Director of the Supervision of Non-Bank Financial Institutions Department with effect from 02 April 2012 and subsequently appointed as Director of the same department with effect from 02 October 2012.
13. Mr. H. Amarathunga, Additional Director of the Provincial Offices Monitoring Department, was appointed as Acting Director of the Provincial Offices Monitoring Department with effect from 01 July 2012 and subsequently appointed as Director of the same department with effect from 01 October 2012.
14. Mr. C. P. A. Karunatilake, Superintendent of the Currency Department, was appointed as Director of the Centre for Banking Studies with effect from 03 September 2012.
15. Mr. V. Baskaran, Additional Director of the Regional Development Department, was appointed as Additional Director of the Policy Review and Monitoring Department with effect from 03 September 2012.
16. Mr. S. K. Ranasinghe, Additional Director of the Financial Intelligence Unit, was appointed as Additional Director of the Bank Supervision Department with effect from 03 September 2012.
17. Mr. C. N. Wijayasekera, Staff Class Grade IV officer, was appointed as Additional Director of the International Operations Department with effect from 01 November 2012.

#### 15.6 Retirements

1. Mr. S. M. A. Siriwardane, Acting Director of the Provincial Offices Monitoring Department, retired from Bank service with effect from 01 July 2012.
2. Mr. K. P. N. S. Karunagoda, Acting Director of the Welfare Department, retired from Bank service with effect from 01 April 2012.
3. Miss. A. S. De Alwis, Additional Director of the Statistics Department, retired from Bank service with effect from 18 February 2012.
4. Mrs. P. Wijesinghe, Additional Secretary of the Secretariat Department, retired from Bank service with effect from 28 August 2012.

#### 15.7 Officers on Release

1. Mr. K. D. Ranasinghe, Assistant Governor, to the International Monetary Fund as an Alternate Executive Director
2. Mr. S. R. Attygalle, Staff Class Grade IV officer, to the Ministry of Finance and Planning
3. Mr. K. M. M. Siriwardana, Staff Class Grade IV officer, to the Ministry of Finance and Planning

4. Mr. M. Mahinda Saliya, Staff Class Grade II officer, to the Ministry of Finance and Planning
5. Mr. S. J. K. Guruge, Staff Class Grade II officer, to the Ministry of Defence and Urban Development
6. Mr. H. M. N. Dharshana, Staff Class Grade II officer, to the Ministry of Defence and Urban Development
7. Mr. J. A. A. Priyantha, Staff Class Grade I officer, to the Presidential Secretariat
8. Mr. K. P. M. Perera, Staff Class Grade I officer, to the Ministry of Defence and Urban Development
9. Mrs. A. C. Abeysinghe, Staff Class Grade I officer, to the International Monetary Fund
10. Mrs. H. M. N. S. Gunawardena, Legal officer (contract), to the Ministry of Finance and Planning

### 15.8 Officers on No-pay Study Leave

1. Mr. U. P. Alawattage, Staff Class Grade IV officer, is on no-pay study leave with effect from 04 September 2012.

## 16. INFORMATION TECHNOLOGY

Entrusted with the task of fulfilling the information and communication technology (ICT) needs of the CBSL, the key objectives of the Information Technology Department (ITD) are to provide and maintain systems on par with the state-of-the-art technology, function as a strategic business enabler, achieve high level ICT usage with a high caliber workforce, mitigate operational risk and provide robust ICT infrastructure for payment and settlement systems of the country.

During the year, in line with the theme "Raising the Bar" as per the strategic plan, ITD successfully carried out its activities under five broad areas.

### 16.1 Introducing New Business Solutions

The ITD continued to provide integrated business solutions to cater to the needs of diverse business processes within the CBSL while providing support and maintenance services for existing automated applications. The following are some of the major business solutions undertaken during the year:

- (a) An Integrated General Ledger (GL) System with interfaces to critical applications to function as the central accounting repository of the CBSL adhering to industry accepted best practices.
- (b) An Integrated Human Resource Management System (eHRNet) for effective human resource management.
- (c) An automated solution for Deposit Insurance Scheme which is a safety net for depositors facilitating overall financial system stability of the country and compliance with International Financial Reporting Standards (IFRS)
- (d) Handling tender procedures to establish a repository (eRecordingRoom) of scanned images of required EPF member details integrating with the main EPF-system for effective decision making.

- (e) Implementation of an automated system for the National Agri-Business Development project with the aim of poverty alleviation
- (f) Simplification of staff welfare loan schemes for efficient internal administration

### 16.2 Enhancing Existing Systems

Maintenance of internally developed solutions was carried out smoothly reaching an annual operational availability of over 99.5% without interruptions to service delivery. The following are some of the major enhancements undertaken.

- (a) Expansion of EPF re-engineering process to introduce a citizen portal integrating with Lanka Government network (LankaGate) to provide efficient public service.
- (b) Expansion of the VideshaVinimaya system to capture the daily foreign exchange requirement in the domestic forex market.
- (c) Expansion of the Central database system (FinNet) to accommodate reporting of IFRS requirements and introduction of a Primary Dealer Reporting System.

### 16.3 Improving Systemically Important Payment and Settlement Systems (SIPSS)

Apart from the above enhancements indicated under 16.2 the ITD carried out major upgrades of the SIPSS to capture anticipated growth in transaction volumes, providing enhanced business facilities for SIPSS.

- (a) Upgrading the SWIFT Alliance Access (SAA) Software in line with the SWIFT road map.
- (b) Upgrading the LankaSettle / LankaSecure application software from CAS/CSS version 3.5 to 3.6 to manage the upgrade in SWIFT messaging standards.
- (c) Replacing hardware and operating system software of LankaSettle system to avoid technology obsolescence.

During 2012, ITD was successful in achieving over 99.8% system availability of SIPSS which contributed to the stability of the financial system.

### 16.4 Developing ICT Infrastructure and Mitigating Risk

The ITD took the following initiatives to develop ICT infrastructure for efficient delivery of IT services.

Three new servers were purchased following procurement procedures to replace old IBM i-series servers deployed for main business operations of the CBSL. Further, arrangements were made to replicate required information online from the EPF IT system to the servers located at Labour Department for improved public services.

The local area network of the CBSL was extended to the LLOYDS building to ensure smooth transition of EPF

operations. The leased line capacity between CBSL Head Office and Lloyds building was upgraded to 4Mbps for increased productivity.

Feature rich collaborative software solutions were purchased under an enterprise agreement with Microsoft Corporation to facilitate electronic mail, document, workflow, backup and IT asset management and comprehensive virus protection.

The security of the local area and wide area networks of the CBSL was maintained at a high standard throughout the year thereby resulting in virtually 0% security breaches while facilitating information system audits conducted by internal and external auditors.

Two (2) BCP drills were conducted successfully during the year from the Disaster Recovery Site (DRS) with the participation of internal departments and external financial institutions to enhance preparedness for emergency situations. In addition, preliminary work was carried out to build a new reinforced DRS that would provide modern facilities for DR operations.

### 16.5 Providing IT Value-added Services

The ITD provided technical expertise and advisory services to projects of national interest as per the road map of the National Payment Council, especially for the introduction of a communication module for the Sri Lanka Interbank Payment System and the ongoing Common Card And Payment Switch (CCAPS) project facilitating for rapid expansion in economic activities. Technical expertise was also extended to the Lanka SWIFT User Group for the mandatory upgrade of SWIFT to ensure the availability of payment messaging platform for SIPSS. The IT Help Desk provided an efficient service with a monthly incident resolution ratio of over 95%.

## 17. INTERNATIONAL OPERATIONS

In terms of the Monetary Law Act, the Central Bank of Sri Lanka (CBSL) is responsible for managing the official foreign exchange reserves of the country with the aim of maintaining the external stability of the Sri Lanka rupee and assuring the maximum possible freedom of the country's international transactions. In this regard, the International Operations Department (IOD) has been entrusted to perform the reserve management function and to monitor the domestic foreign exchange market to ensure its smooth operations.

### 17.1 International Reserve Management

Section 67 of the Monetary Law Act provides the legal framework for deployment of the foreign currency reserves and gold, defining broad parameters in respect of currencies, instruments, issuers and counterparties. The Monetary Board may direct to hold international reserves in gold or currencies freely convertible into gold, particularly considering the prospects of stability and convertibility of the currencies as well as the anticipated demand for such currencies. It may also direct to further widen the scope of reserve management activities to enhance the safety, liquidity and return objectives of reserve management. With a view to further streamline the portfolio management activities, the CBSL

has framed appropriate guidelines stipulating stringent criteria for issuers, counterparty investments, maturity profile and risk monitoring which have been approved by the Monetary Board.

Accordingly, investments of the international reserves were undertaken in accordance with the Foreign Exchange Reserves Management Guidelines approved by the Monetary Board and under the supervision of the Foreign Reserve Management Committee (FRMC). The international reserves were invested mainly in two asset classes namely, Fixed Income Securities and money market instruments including gold. Liquidity requirements of the Bank, debt service payments, risk management parameters, income generating abilities and specific directions of the Monetary Board were the key factors considered in determining the asset and currency composition of the reserves portfolio.

IOD managed to earn a reasonable rate of return on its reserves through prudent investments made during the year 2012, at a time when global reserve managers were facing a conundrum of where to allocate their resources. The major challenges faced in reserve management in 2012 included, the ongoing debt crisis in the European region, the delay in reaching a debt reduction deal by the US congress, i.e., fiscal cliff concerns in the United States, decreasing bond yields, the changing dynamics for G7 sovereign debt and accelerating uncertainty in the financial markets due to factors such as political uncertainties in Europe, unrest in the Middle East and natural disasters in the United States.

The Bank's overall reserve management operations generated a foreign income of US dollars 221 million (approximately Rs. 28 billion) during the year 2012, which is over 4 per cent returns on average reserves. In the midst of the comparatively low interest market environment, progress was made under challenging circumstances in generating a significant income through foreign currency and gold trading by maximizing the opportunities arising from market fluctuations and capital gains derived on fixed income securities.

With a view to enhance the reserve management activities, the modernization programme of the dealing room continued, which included the procurement of a new Treasury Management System (TMS). The agreement was signed for this new system in November 2012. The live implementation of the system would commence at the beginning of 2014. Shift working arrangements were continued during the year under review to cover different time horizons of global financial markets.

### 17.2 Risk Management

The Middle Office of IOD is responsible for identifying, assessing and managing the risks associated with the investment of international reserves, on a continuous basis. Risks arising from reserve management operations were mitigated by closely monitoring changes in international market conditions and exercising prudence in taking decisive actions to lessen their potentially harmful consequences and by ensuring that the reserve management operations are within the parameters specified by the Reserve Management Guidelines.

**Exchange rate risk or currency risk** was managed through portfolio diversification and the use of strategic currency combinations, considering impending foreign currency liabilities as well as global currency market outlook and trade patterns. Value at risk (VaR) computations were used to assess the exposure to short term depletion in the value of the Fixed Income Securities (FIS) portfolio and ensure that it was maintained at a comfortable level. "Stop Loss Orders" and "Dealer Limits" were utilized to curb potential foreign exchange losses arising from trading activities. **Interest rate risk** was mitigated by varying the durations of the fixed income and money market investments in a timely manner, based on the expected yield curve movements. Sensitivity analyses were used to gauge risk exposure to changes in interest rates, followed by timely actions to mitigate the risks.

The "Counterparty Credit Risk Management System" (CCRMS) facilitated the comprehensive evaluation of counterparties based on financial indicators, credit ratings and their market exposures, in order to manage the **counterparty credit risk**. Credit default swap (CDS) rates and stock market prices of the counterparties were also monitored to identify potential risks they were exposed to. The credit limits of a number of counterparties which had their ratings lowered during the year were reduced to minimise CBSL exposure to them and a few were subsequently removed from the list of eligible counterparties. Improved cash flow management and forecasting techniques helped ensure that a sufficient proportion of assets in respective currencies were held in liquid form throughout the year. This helped minimize the **liquidity risk** and all payments were honored in a timely manner, sans default. The **operational risk** arising from the employees, systems and processes that are in place to support the management of international reserves was mitigated by strengthening the internal controls and investment guidelines and by conducting operations from the disaster recovery site.

### 17.3 Domestic Foreign Exchange Market Developments

In order to ensure a smooth functioning of the domestic foreign exchange market, IOD continued to monitor foreign exchange transactions and initiated appropriate actions to curb any excess volatility in the USD/LKR exchange rate. Further, adherence to the stipulated overnight net foreign exchange open position limits by licensed commercial banks was also closely monitored. In Addition, compilation and dissemination of exchange rates to various government, local and foreign agencies and to the general public were also continued.

During the year, net open positions in foreign currency of licensed commercial banks were reviewed and revised downwards to mitigate the risks in the foreign exchange market. In February 2012, CBSL implemented a major change in the exchange rate policy of the country, resulting in the conduct of interventions in the market using quantities instead of price targets.

The market monitoring activities carried out by the department assists commercial banks to engage in

foreign currency transactions prudently, thus enhancing the confidence of the general public regarding the foreign exchange activities undertaken by commercial banks. Minimizing undue fluctuations in the foreign exchange rates helped customers who need to purchase or sell foreign currency, to forecast their commitments with more accuracy and also to minimize their foreign exchange risk exposure. Further, the general public as well as many other government, local, and foreign agencies benefit from the information disseminated by IOD on the exchange rate of the Sri Lankan rupee against other currencies as they get access to a reliable indicative rate for their day to day activities involving foreign currency.

**Table II-17 Inter-Bank Foreign Exchange Transactions Volume - 2012**

US dollars mn

Months	Spot	Tom	Cash	Forward	Total
January	656.30	192.05	147.00	460.08	1,455.43
February	911.97	237.75	111.75	514.62	1,776.09
March	547.72	194.00	105.80	337.05	1,184.57
April	473.31	141.05	133.51	196.73	944.60
May	307.00	150.20	82.01	330.96	870.17
June	233.98	227.40	101.56	420.80	983.74
July	482.30	334.40	126.44	307.47	1,250.61
August	215.40	184.45	172.52	246.44	818.81
September	317.85	209.10	206.70	340.92	1,074.57
October	386.69	293.83	222.70	412.74	1,315.96
November	299.60	207.60	142.60	245.07	894.87
December	303.24	166.85	104.02	276.37	850.48
<b>Total</b>	<b>5,135.36</b>	<b>2,538.68</b>	<b>1,656.61</b>	<b>4,089.25</b>	<b>13,419.90</b>

Source: International Operations Department, Central Bank of Sri Lanka

**Table II-18 Purchases and Sales of Foreign Exchange by the Central Bank - 2012**

US dollars mn

Months	Purchases	Sales	Net Purchases/ (Sales)
January		609.80	(609.80)
February		367.43	(367.43)
March	124.59	177.95	(53.36)
April		153.70	(153.70)
May	19.00	62.73	(43.73)
June	325.00	38.38	286.62
July	21.00	50.75	(29.75)
August	5.00	15.75	(10.75)
September	23.00	300.00	(277.00)
October	36.70	6.40	30.30
November		7.85	(7.85)
December	77.00	6.30	70.70
<b>Total</b>	<b>631.29</b>	<b>1,797.04</b>	<b>(1,165.75)</b>

Source: International Operations Department, Central Bank of Sri Lanka

## 18. MANAGEMENT AUDIT

The internal audit function of the Bank is carried out by the Management Audit Department. Further, it facilitates the Monetary Board Advisory Audit Committee (AAC) and external audit through the Secretary to the Monetary Board who is also the Secretary to the AAC. In addition, capacity building programmes on internal auditing were also arranged. The internal audit function has been in operation since 1951 in the Bank. A summary of the activities carried out during 2012 is given below.

### 18.1 Conduct of Audit Assignments

#### (a) The Internal Audit Primary Focus

In 2012, internal audit focused on assurance of compliance by the Departments of the Bank with applicable laws, policies and internal controls and resolution of audit concerns/observations by the respective management lines. The Department, in conducting audit assignments followed the auditing standards of the Institute of Internal Auditors, USA and industry best practices.

Mission and scope of work of the Department and the accountability, independence, responsibility and authority of the Director of the Management Audit Department (DMA) and the staff have been defined in the Internal Audit Charter.

#### (b) Annual Audit Plan for 2012

The Annual Audit Plan was prepared covering significant activities of all clusters of the Bank and approval was obtained in terms of the current procedure from the AAC for implementation. The audit process followed four steps, i.e., planning, performing, communicating and resolution. The resolution of audit concerns took place while audit being in place or during the communication of audit results. In this regard, the Department completed several audit assignments covering significantly important operations of the Bank with appropriate resolution actions. In addition, follow-up audits to verify the status of implementation of the resolution agreed by respective management personnel were also conducted.

#### (c) Reporting of Audit Progress

The progress of conduct of audit assignments was reported to the Governor and AAC quarterly whereas the DMA and the AAC reported the same to the Monetary Board together with recommendations of AAC. Audit activities conducted were also reported to the Auditor General on a half-yearly basis.

### 18.2 Monetary Board Advisory Audit Committee

The AAC functions in line with the best practices followed by the Bank for International Settlements and

the provisions of the Government Circular on Audit Committees of state corporations. The AAC comprises of one member of the Monetary Board and two external audit professionals. The AAC meets every two months. During the year, the AAC had six meetings and made recommendations. DMA provided facilitation for the AAC through the Secretary to the AAC.

### 18.3 Facilitation of External Audit

In 2012, the Secretary to the Monetary Board functioned as the authorised management officer to co-ordinate external audit and resolution actions on audit concerns. The Auditor General conducts external audit. For the purpose of audit of financial statements in terms of International Financial Reporting Standards, Ernst & Young has been engaged by the Auditor General. Accordingly, the Department provided technical inputs to the Secretary to the Monetary Board to collect necessary information, analyse the findings and handle correspondence.

### 18.4 Awareness Programmes and Provision of Training

In view of need for information systems security in the Bank, a seminar on 'Ensuring IT Security through Information Systems Audit' was arranged through an expert on the subject for the benefit of Bank employees. The services of the Department were also extended to local and foreign trainees by way of providing training on internal auditing to undergraduates, students of the Institute of Chartered Accountants of Sri Lanka and officers of the Bangladesh Central Bank. Further, the Department provided resource persons for the programme conducted by the Centre for Banking Studies for the officers of Nepal Rastra Bank.

## 19. PAYMENTS AND SETTLEMENTS

The Payments and Settlements Department (PSD) was established in 2002 with the restructuring of the CBSL under the CBSL Modernization Project. The statutory mandate entrusted to CBSL under the Payment and Settlement Systems Act No. 28 of 2005 to regulate and oversee the payment and settlement systems in the country and to implement the national payment system policy with the objective of ensuring safety, efficiency, competitiveness and stability of the payment and settlement systems in Sri Lanka, has been carried out through PSD.

The main activities performed by PSD are operations of the Real Time Gross Settlement System, the back-office functions to process and effect payment and settlement instructions in respect of CBSL's foreign exchange reserve management and open market operations, management of the SWIFT communication system, effecting fund transfers through the Asian Clearing Union and policy formulation and oversight of the payment and settlement systems. A summary of the main functions performed by PSD are given below.



### 19.1 Real Time Gross Settlement (RTGS) System

PSD continued to settle inter-participant payments as well as customer payments on real time gross basis and facilitated and monitored the provision of the Intraday Liquidity Facility (ILF) to the participants who requested extra funds to ensure smooth functioning of the RTGS System.

- The total volume of transactions settled by the RTGS System during 2012 was 284,561 with a total value of Rs. 43,255 billion.
- The average volume and average value of RTGS transactions settled per day were 1,176 and Rs. 179 billion, respectively.
- On average, Rs 15.2 billion per day was released to participants through the ILF.
- PSD maintained system availability of 99.81% during the year 2012.

### 19.2 Settlement of Foreign Exchange Transactions

During the year 2012, PSD continued back-office functions pertaining to international reserve management transactions carried out by the International Operations Department (IOD).

- PSD settled 19,602 transactions during 2012 relating to foreign exchange trading and funding, money market, fixed income securities and gold trading transactions amounting to US Dollars 226 billion.
- PSD got involved in the dealing room modernization project by providing inputs with regard to back-office requirements.
- Shift-based working system was continued throughout the year 2012 in order to facilitate the high volume of transactions that originated from IOD.

### 19.3 Settlement of Transactions under Open Market Operations (OMO)

Back-office functions for open market operations were carried out by PSD through the allocation of securities to LankaSettle participants based on the repo and reverse repo transactions entered into by them.

- PSD effected 4,016 repo transactions amounting to Rs. 2,722 billion, 1,097 reverse repo transactions amounting to Rs. 798 billion and 36 transactions on outright sales amounting to Rs. 18 billion.

### 19.4 SWIFT Communications

PSD maintained the SWIFT System of CBSL, which handles all SWIFT communications of CBSL with other domestic and international financial institutions.

- In 2012, total SWIFT messages sent and received were 1,384,174 and 818,612, respectively.
- PSD successfully installed a new upgraded version of SWIFT to improve efficiency of the system.

- SWIFT service was also made available from 8:00 a.m. to 8:00 p.m. under the shift-based working system in order to facilitate the foreign exchange transactions of CBSL.

### 19.5 Transactions under the Asian Clearing Union

PSD facilitated payments for intra-regional transactions of the nine member countries of the Asian Clearing Union (ACU) through ACU mechanism.

- The total value of transactions effected through ACU mechanism was Rs. 421.9 billion in 2012.
- The 41<sup>st</sup> meeting of the Board of Directors of ACU was held in Nepal in May 2012 and the Governor and the Director of PSD participated at the meeting as a Director of the Board of Directors and the Alternate Director, respectively. The meeting focused mainly on the recommendations of the ACU Technical Committee, i.e. establishment of ACU Trade and Development Bank, set up a task force for dispute resolution, incorporate period of preservation of the ACU records in the ACU Procedure Rules and implementation modalities and cost estimate of the web-based application for ACU messaging, accounting and reconciliation.

### 19.6 Payment System Policy and Oversight

PSD carried out regulatory and supervisory activities to ensure payment and settlement system stability by maintaining safe, sound and efficient payment and settlement systems in the country. Accordingly, the following were the major oversight activities carried out by PSD.

- Five applications submitted in terms of the Service Providers of Payment Cards Regulations No. 1 of 2009 were evaluated and licences were issued to three service providers to engage in payment card business and a licence was also issued to a mobile network operator to operate an e-money based mobile payment system in Sri Lanka.
- Renewal applications were evaluated and licences of 17 service providers of payment cards were renewed.
- In order to address several operational and legal issues encountered in the regulation of payment cards and mobile payment services, action was initiated to amend the Service Providers of Payment Cards Regulations No. 1 of 2009.
- Adoption of Terminal Line Encryption Technology by card acquiring banks was monitored to ensure safe credit card operations in Sri Lanka.
- Business Continuity Plans (BCPs) of LankaSettle participants were evaluated to ensure that they had updated BCPs based on the Guidelines issued by CBSL.
- PSD published the quarterly "Payments Bulletin" in the CBSL website for dissemination of information on payment and settlement systems in the country.

PSD maintained the LankaSettle System with a system availability of 99.81 per cent during the year ensuring timely interbank settlements including settlements for cheque clearance balances, Sri Lanka Interbank Payment System and other payment systems in order to facilitate timely settlement of transactions while achieving payment and settlement system stability. Further, PSD conducted awareness programmes to educate the general public and the banking community on payment systems and other related issues to encourage them to use electronic payment systems which are safer and were efficient than paper based payment systems. Meanwhile, as the major concern of the PSD in regulating the card based payment systems and the mobile phone based payment systems was customer protection, PSD ensured compliance to the credit card and mobile payment guidelines by service providers to protect customers of such systems thereby providing a secured and reliable environment for the general public to carry on day to day retail payments.

## 20. POLICY REVIEW AND MONITORING

The mandate for the Policy Review and Monitoring Department (PRMD) which was established in 2007, is to conduct policy reviews and studies, coordinate the preparation of Strategic Plan of the CBSL and to monitor the progress of the implementation of the Strategic Plan. Under this, the department attended to the following activities during the year.

### 20.1 Conducting Policy Reviews and Studies

PRMD was engaged in several studies including policy studies such as "Macro-economic Impact of Recent Policy Changes" and "Financial Inclusion in Sri Lanka" and other studies covering the areas of "Saubagya Loan Scheme", "Problem Financial Institutions Resolution Framework" and "Measures Taken to Improve Human Resources in the CBSL." The on-line e-Policy and Procedure Library was updated regularly with policy related documents issued by the departments of the CBSL. The e-Policy and Procedure Library carried 844 policy related documents by end 2012. In addition, staff members of the department were engaged in knowledge sharing work and made 08 internal presentations on policy issues.

### 20.2 Coordinating the Strategic Planning Process

The seventh strategic planning retreat of the CBSL conducted from 5<sup>th</sup> October to 7<sup>th</sup> October, 2012 at hotel Jetwing Blue, Negombo was organized by PRMD. Several members of the Monetary Board, Corporate Management team, committee members of Consultative Committees of the CBSL, Heads and Additional Heads of departments and their representatives participated at this retreat to prepare the Strategic Plan for 2013 - 2017, under the theme of "Prepare \$4K Ahead". The purpose of the retreat was to review the progress of achievement under the Strategic Plan 2012 - 2016 and update it on a rolling plan for the next five years. Prior to the retreat, PRMD also conducted 32 pre-retreat meetings with all the departments and provincial offices of the CBSL to ensure that the selected theme was adequately reflected in the respective departmental Strategic Plans.

## 20.3 Monitoring the Implementation of the Current Strategic Plan 2012 - 2016

The 6<sup>th</sup> Strategic Plan of the CBSL for the period 2012 - 2016 under the theme of "Raising the Bar" was launched together with a two day awareness workshop for all staff members of the CBSL during the first week of January 2012. A survey, carried out as a part of the workshop, revealed that the staff of the Bank possessed a fair knowledge about the Strategic Plan and the main elements of the strategic planning process.

PRMD conducted quarterly progress review meetings with each department and provincial offices to assess the level of their achievements under the Strategic Plan 2012 - 2016 and to identify issues that hindered the successful implementation of the Strategic Plan. Outcomes of the review meetings were reported to the Strategic Plan Review Committee (SPRC), which is chaired by the Governor and comprises of the members of corporate management of the CBSL. Based on the reports, remedial actions were taken by the management to ensure the path of the Strategic Plan. The PRMD communicated the decisions of the SPRC to respective departments and provincial offices and necessary follow up measures were taken to ensure achievement of the objectives of the Strategic Plan. The annual progress review showed that the CBSL has achieved on average 97.1% of the expected activities, assigned to the departments and provincial offices in 2012. The Department also provided training to 53 interns during the year.

## 21. PROVINCIAL OFFICES MONITORING

The Provincial Offices Monitoring Department (POMD) was established in 2009 with the view of monitoring the effectiveness of Central Bank functions including developmental activities carried out by the Provincial Offices (POs) at regional level. Accordingly, the POMD is engaged in monitoring the activities of five POs currently operated in Southern, North Central, Central, Northern and Eastern provinces.

### 21.1 Monitoring the Activities of the POs

At the beginning of the year 2012, the POMD in consultation with the relevant Departments of the Central Bank assigned specific functions to the POs with the view of implementing effectively the major activities of the Central Bank at regional level. The POMD performed its off-site monitoring of the work assigned to the POs based on the weekly and the monthly progress reports submitted by them. In addition, the officers of the senior management and the POMD made 33 visits to the POs and participated in programmes conducted by them while interacting with programme participants closely, as part of on-site monitoring. Further, during the year, the Department conducted 4 teleconferences and 7 meetings in person with the Provincial Managers (PMM) and other officers of the POs to review the progress.

Table II-19

## Programmes Conducted by the Provincial Offices During 2012

Provincial Office	Awareness Programmes		Skill Development Programmes	
	No. of Programmes	No. of Participants	No. of Programmes	No. of Participants
Southern Province	84	6,606	37	1,032
North Central Province	89	7,707	38	1,378
Central Province	107	6,966	31	1,044
Northern Province	114	8,530	17	569
Eastern Province	75	6,846	32	1,361
<b>Total</b>	<b>469</b>	<b>36,655</b>	<b>155</b>	<b>5,384</b>

## 21.2 Activities of the POs

### (a) Expansion of the CBSL Functions in the Provinces

During the year, the POMD continued to assist the decentralization of key functions of the CBSL at regional level through the five POs. Under this, the POs conducted 469 awareness programmes to educate the general public and officers in the Government and financial institutions on CBSL credit schemes and other selected topics such as investment in Government Securities, inculcation of good banking habits, identification of forged currency notes and good habits of using currency notes and consequences of investing in unauthorized finance companies and prohibited schemes, as required by relevant Departments of the CBSL. The POs also provided assistance to the several Departments of the Central Bank in conducting surveys on selected subjects and inspections on illegal financial institutions located in the regions. The POs attended inquiries relating to EPF matters and sold CBSL publications and commemorative coins. Further, each PO prepared detailed reports on the resources, business and investment opportunities available in the respective province. The staff of the POs completed the compilation of a comprehensive data profile of 7,500 beneficiaries and continued to update provincial data. The PMM represented the Central Bank at important forums on development matters in the respective provinces.

### (b) Development Activities

Five POs were engaged in promoting economically viable investments in the respective provinces, under several credit schemes operated by the RDD. Further, in consideration of the low level of credit being granted in Uva province, the PO-Central Province and the PO-Southern Province took initiatives to expedite credit flow to the province through a series of awareness programmes conducted on the CBSL credit schemes with the participation of prospective investors and bank officers of the province. The POs also conducted 155 skill development programmes covering subject areas such as scientific farming practices, post-harvest techniques, high-tech agriculture, best practices in medium and small scale projects in association with the relevant institutions in the provinces.

The details of programmes conducted by the POs during 2012 are given in table II-19.

## 22. PUBLIC DEBT

In terms of the section 113 of the Monetary Law Act, the Central Bank of Sri Lanka has been charged with the responsibility for the management of the public debt. Accordingly, the Public Debt Department (PDD) continued to engage in activities relating to the issuance, servicing and management of domestic debt and servicing of foreign debt on behalf of the government. A summary of activities of the PDD during 2012 is given below.

### 22.1 Raising of Funds for Financing the Government Budget

PDD continued to engage in raising funds from domestic and foreign sources for financing the government's gross borrowing requirement of Rs. 1,139 billion in 2012. On net basis, the total borrowing requirement of the government in 2012 amounted to Rs. 468.9 billion. A summary of such financing activities under different debt instruments used in 2012 is given below:

#### (a) Treasury Bills

Treasury bills amounting to Rs.1,650 billion (face value) were issued in 2012 through 52 weekly Treasury bills auctions and direct placements. Of the total issuances in 2012, Rs. 1,602 billion represented the re-issuances of maturing Treasury bills while only Rs.48 billion was added in the form of new Treasury bills to the net borrowing amount.

#### (b) Treasury Bonds

During 2012, a total of Rs.968 billion (face value) was raised through Treasury bonds. In addition to 9 primary auctions, the issuances of Treasury bonds in 2012 were made through direct placements as well.

#### (c) Sri Lanka Development Bonds

During 2012, PDD conducted three primary auctions in Sri Lanka Development Bonds in March, July and September and raised a total of US\$ 456.5 million or Rs. 58.8 billion. Of the total of such issuances US\$ 317 million was re-issuances of maturing SLDBs while only US\$ 139.5 was made as new issuances in 2012.

#### (d) International Sovereign Bond

In 2012, PDD facilitated the issuance of the fifth International Sovereign Bond on behalf of the Government to raise US\$ 1,000 million from the international capital market, partly to finance the maturing international sovereign bonds of US\$ 500 million and the balance for the net borrowing requirements of the Government.

#### 22.2 Servicing of Public Debt

PDD continued to maintain the country's unblemished record in servicing of public debts by ensuring the accuracy in terms of counterparty, amount and timing in 2012 as well. Accordingly, a total of Rs. 1,025 billion debt service payments were made in 2012 on account of 250 domestic loans and 672 foreign loans.

#### 22.3 Facilitation of the Settlement of Scripless Securities in Government Securities

With a view to maintaining the efficiency and effectiveness of the secondary market for government securities, PDD continued to facilitate settlement of trading in scripless government securities throughout 2012 by ensuring smooth functioning of the Scripless Securities Settlement System (SSSS). The total value of scripless securities trading transactions settled through LankaSecure participants in 2012 amounted to Rs. 3,205 billion. Among members of LankaSecure participants, there were 24 licensed commercial banks (LCBs), 7 non-bank primary dealers, and 3 non-dealer direct participants.

#### 22.4 Maintenance of the Title Registry in Government Securities

PDD in 2012 continued to record the changes in ownership of government securities in the Central Depository System (CDS) on an ongoing basis and to disseminate semiannual statements on holdings of government securities, monthly statements on transactions and payment statements to CDS account holders. Accordingly, a total of 36,023 semiannual statements of holdings and 98,538 monthly statements of transactions and 72,647 payment statements were dispatched by mail in 2012 to the account holders of CDS. The total number of accounts holders at CDS stood at 78,896 at the end of 2012.

#### 22.5 Supervision of Primary Dealers in Government Securities

The regulation of Primary Dealers in government securities (PDs) as required by the Local Treasury Bills Ordinance and the Registered Stock and Securities Ordinance is vested with the Central Bank of Sri Lanka. Accordingly, PDD continued to engage in activities relating to the supervision of PDs in 2012. Financial soundness, performances and also the market conduct of PDs are supervised by PDD on a regular basis with a view to ensuring stability of the PD system and the safety

of investors in government securities. With respect to the regulation of PDs, PDD continued to engage in the following activities in 2012.

##### (a) Examination of Primary Dealers

Three examinations that continued from 2011 and four examinations that began in 2012 were completed in 2012 and the key supervisory concerns were communicated to each PD with a time bound action plan to rectify such issues. Two examinations are in the process of completion. PDD focused on risk assessment of individual PDs, adequacy of capital, liquidity, asset quality, profitability etc. and the adherence to prudential directions, guidelines and good governance procedures during these on-site examinations. The progress of the rectification of regulatory concerns was monitored through quarterly reports sent by PDs.

##### (b) Off-site Surveillance

Off-site surveillance is an ongoing monitoring mechanism of the financial soundness and operational performance of individual PDs based on a number of periodic returns submitted to the Superintendent of Public Debt. It serves as an early warning system of potential adverse developments of individual PDs as well as the PD industry as a whole, that needs prompt corrective action. During the year, 12 such off-site surveillances per month were carried out and prompt corrective action was taken by PDD as and when necessary.

#### 22.6 Monthly Meetings of CEOs of PDs and the CBSL

12 monthly meetings of the Chief Executive Officers of PDs with the Superintendent/Registrar of Public Debt were organized by PDD in 2012. These meetings serve as the forum for exchanging of views on the economic and monetary developments, performance of PD industry and many other areas that have an impact on the performance of primary and secondary market activities in government securities and market development.

#### 22.7 Government Securities Market Development

A developed government securities market is an essential element to reduce the refinance risk and the cost of borrowing of the government. Hence, PDD continued to engage in developing the government securities market in 2012 as follows:

- (a) Enhancing the benchmark yield curve for longer tenures by issuing benchmark securities on a periodic basis and by minimizing fragmentation. Further, PDD limited the number of issuances and increased the issue size of Treasury bonds that helped improving market liquidity.
- (b) Introduction of an electronic trading platform for government securities with a view to provide

the market a mechanism for price discovery and price transparency.

- (c) Conducted 8 public awareness programmes including seminars, participation in exhibition and TV programs during the year with a view to improving the retail market for government securities.
- (d) LankaSecure was upgraded to the latest version to ensure compliance with new Society for Worldwide Interbank Financial Telecommunication (SWIFT) messaging standards.

## 22.8 Ensuring the Availability of International Sovereign Ratings

Ensuring the availability of international sovereign ratings from international rating agencies is charged with the Central Bank and PDD continued to engage in activities pertaining to the availability of sovereign ratings in 2012. In addition to facilitation of four meetings of international rating agencies, PDD provided data and information to credit rating agencies on the developments in the economy throughout the year.

### Annex II-2

#### Primary Dealers in Government Securities

1. Acuity Securities Ltd
2. Bank of Ceylon Primary Dealer Unit
3. Capital Alliance Ltd
4. Commercial Bank of Ceylon PLC Primary Dealer Unit
5. Entrust Securities Ltd
6. First Capital Treasuries Ltd
7. NatWealth Securities Ltd
8. NSB Fund Management Co. Ltd
9. Peoples Bank Primary Dealer Unit
10. Sampath Bank PLC Primary Dealer Unit
11. Seylan Bank PLC Primary Dealer Unit
12. WealthTrust Securities Ltd

## 23. REGIONAL DEVELOPMENT

The Regional Development Department is engaged in an agency function on behalf of the government to achieve balanced growth in the country while promoting financial inclusiveness.

With the view of achieving this objective, the Regional Development Department (RDD), in 2012, engaged in activities aimed at promoting regional development by coordinating, facilitating and implementing concessionary credit schemes and delivering credit supplementary services for beneficiaries in the agriculture, livestock and micro, small and medium sector enterprise (MSME) sectors through the network of Participating Financial Institutions (PFIs) and their branches. These credit schemes and credit supplementary services were

funded by the Government of Sri Lanka (GOSL), CBSL, donor agencies and PFIs. The strategic objectives of these programmes included enhancement of regional growth, reduction of poverty by enhancement of financial inclusiveness, creation of income generating activities and employment opportunities, facilitation of obtaining the services of the formal financial sector, provision of skills development and training, strengthening of business and economic activities in lagged regions and enhancement of production of essential food items to ensure food security.

During 2012, the performance of RDD in terms of providing refinance or interest subsidies under various loan schemes to PFIs is given in Table II-20.

### 23.1 Agriculture and Animal Husbandry Sector

The New Comprehensive Rural Credit Scheme (NCRCS), which provides working capital requirements of small farmers, granted Rs. 6,001 million among 72,336 farmers during the 2011/12 Maha season. This indicates a growth of 69 per cent, in terms of value of loans and 22 per cent in terms of number of loans, over the corresponding season of the previous year. Amount of loans granted in 2012 Yala season under the NCRCS was Rs. 3,359 million, an increase of 15 per cent over the corresponding Yala season in the previous year. The number of farmers benefitted was 40,077 compared to 39,496 farmers in the previous Yala season. This increase in loan disbursement was reflected in cultivated land area of paddy and other crops. Paddy represented 58 per cent of the loans provided under the NCRCS while onion represented 24 per cent. The balance was shared by potato, maize, chilies, vegetables and other food crops. In the previous year, the share of paddy under the NCRCS was 64 per cent. Over the years, data reflects a gradual decline of the share of loans given for paddy under NCRCS due to diversification of cultivation of the other short term crops. As in the previous year, Jaffna emerged as the district that accounted for the highest amount in agricultural loans under the NCRCS recording a share of 30 per cent followed by Anuradhapura, Polonnaruwa, and Killinochchi Districts.

The Viskam Loan Scheme which provides credit for diversification and improvement of commercial agribusiness activities granted Rs. 523 million among eligible investors. This was an increase of 47 per cent over the loans granted in the previous year. Under the Viskam scheme, agro based industries and dairy projects received highest share of the loans. Meanwhile, the Agro-Livestock Development Loan Scheme (ALDL), which was introduced to promote liquid milk production in the country, disbursed Rs. 247 million among eligible recipients while the Second Perennial Crops Development Project – Revolving Fund Loan Scheme and the Tea Development Project – Revolving Fund Loan Scheme granted Rs. 173 million and Rs. 104 million respectively during the year.

In 2012, PFIs disbursed Rs. 10,464 million worth of loans through several credit schemes implemented by RDD on agriculture development. This was an increase of 39 per cent over the previous year. The increase in

credit delivery was instrumental in increased level of production of agricultural produce to the domestic market which in turn helped stabilizing the food prices in 2012.

**Table II-20**
**Regional Development Leading Programmes Implemented by Regional Development Department (During the year 2012)**

	Name of the Project	Source of Funds	Broad Mission	Fund Allocation (Rs. Mn.)	Funds Disbursed in 2012 (Rs. Mn.)	Balance to be Disbursed (Rs. Mn.)	Annual Interest Rate to Borrowers
<b>1</b>	<b>Agriculture and Animal Husbandry Sector</b>						
1.1	Second Perennial Crops Development Project - Revolving Fund (SPCDP-RF)	GOSL	Commercialisation of perennial crop sector, increasing production, nursery development, post-harvest handling and processing activities and marketing.	1,200	174	2	9%
1.2	Tea Development Project - Revolving Fund (TDP-RF)	GOSL	Increasing tea small holders' income on a sustainable basis and developing the necessary infrastructure to meet the requirements of the export market by modernising tea factories to obtain HACCP certification.	1,100	131	243	9%
1.3	"Viskam" Credit Line for Development of Commercialised Agribusiness <sup>1</sup>	CBSL	Development of commercial agribusiness through diversification and making other improvements in the agribusiness activities.	1,326	524	Fully utilised.	8%
1.4	New Comprehensive Rural Credit Scheme (NCRCS)	PFIs own funds and Government interest subsidy	Uplifting the socioeconomic conditions of micro and small scale farmers who engage in cultivation of paddy and short term crops.	Depends on the demand for funds.	9,360		8%
1.5	Agro-Livestock Development Loan Scheme (ALDL)	PFIs own funds and Government interest subsidy	To establish scientific dairy farming and allied activities.	Depends on the demand for funds.	247		8% for small dairy projects 12% for milk and crop processing
<b>2</b>	<b>Micro, Small and Medium Enterprises Sector</b>						
2.1	Sabaragamuwa Province Integrated Rural Development Project -Revolving Fund (SPIRDP-RF)	GOSL	Promoting income generating activities in the project area.	100	19	Fully utilised.	10%
2.2	Sabaragamuwa Province Integrated Rural Development Project (Phase II) (SPIRDP - II)	GOSL	Promoting income generating activities in the project area.	70	17	Fully utilised.	12%
2.3	Self Employment Promotion Initiative Loan Scheme (SEPI) <sup>1</sup>	GOSL	To provide financial assistance to youth trained by recognized vocational training institutions.	116	45	4	10%
2.4	Awakening North Loan Scheme - Phase II	CBSL	To assist prospective loan beneficiaries in the Northern Province to strengthen their economic activities.	2,154	668	1,486	9%
2.5	Resumption of Economic Activities in the Eastern Province Loan Scheme – Phase II	CBSL	Enhancing living standards of Eastern Province community by financing existing and new income generating activities.	1,078	528	550	9%
2.6	The Prosperity Loan Scheme ("Saubagya") <sup>1</sup>	CBSL	To start up, expand any micro, small and medium scale enterprise (MSME) or any MSME affected by disasters.	4,720	2,488	237	9%

2.7	Provincial Development Credit Scheme	CBSL	To assist income generating activities of medium and large scale projects in Agriculture, Animal Husbandry, Fisheries, Trade, Transport sectors.	2,900	340	254	12%
2.8	Repair of Damaged Houses in the North and East	CBSL	To provide credit facilities for repairing the damaged houses that were damaged during the conflict in the Northern and Eastern Provinces.	100	84	16	8%
2.9	Construction Sector Development Project (CSDP)	AFD*	Financing the purchase of machinery by companies rated by the Institute of Construction, Trade and Development for post-tsunami reconstruction activities.	1,400	27	Less than one million	9%
2.10	Post Tsunami Coastal Rehabilitation & Resource Management Programme (PTCRRMP) <sup>2</sup>	IFAD*	To assist the communities adversely affected by tsunami disaster through recovering their assets and re-establishing the foundation of their usual activities.	148	97	15	8% - 10%
2.11	Matale Regional Economic Advancement Project - Revolving Fund (MREAP-RF)	IFAD	Raising the income of rural and farm families by providing funds for small and medium scale enterprises in the District.	77	12	Fully utilised.	10%
<b>3.</b>	<b>Microfinance Sector</b>						
3.1	Small Farmers & Landless Credit Project -Revolving Fund (SFLCP-RF)	GOSL	Channelling formal credit to income generating activities for the rural poor to improve the economic conditions and general welfare of the beneficiaries.	345	180	Recoveries will be revolved	14%
3.2	Poverty Alleviation Microfinance Project -Revolving Fund (PAMP-RF)	GOSL	Poverty alleviation through promotion of income generating activities and organising low income groups to link them with formal banking system.	1,031	387	Recoveries will be revolved	12%
3.3	Poverty Alleviation Microfinance Project II (PAMP II) <sup>2</sup>	GOSL JICA*	Poverty alleviation through promotion of income generating activities and organising low income groups to link them with formal banking system.	2,104	652	200	12% -15.5%
3.4	Dry Zone Livelihood Support and Partnership Programme	IFAD	Poverty alleviation and assisting in income generation among the poor farmers in the Districts of Monaragala, Kurunegala, Badulla and Anuradhapura.	252	84	Fully utilised.	10%
3.5	Small Holder Plantation Entrepreneurship Development Programme (SDEnDP) <sup>2</sup>	IFAD and USAID*	Improving the livelihood of marginalised small holders of tea and other perennial crops in the mid country region and poor upland food crop farmers in the intermediate zone of Monaragala District to take up rubber cultivation.	295	57	217	9%

1. New funds have been allocated in 2012

2. Loans given in 2.10, 3.3 and 3.5 are in foreign currencies of SDR 1.02 million, JPY 2,100 million and SDR 1.75 million respectively and the conversion to Rupees at the exchange rate prevailed on the date of loan agreement.

\* AFD; Agence Francaise De Developpement

IFAD; International Fund for Agricultural Development

JICA; Japan International Cooperation Agency

USAID; United States Agency for International Development

### 23.2 Development of SME Sector

In 2012, RDD continued to assist the SME sector with number of loan schemes that disburse loans at concessionary interest rates. Saubagya Loan Scheme, initiated in 2010, provides credit facilities for micro, small and medium scale enterprises (MSMEs) and MSMEs affected by disasters. This scheme covers the entire island and provides loans up to a maximum of Rs. 500,000 to start MSMEs while grants up to Rs. 20 million of credit for disaster affected MSMEs. In 2012, Rs. 2,464 million was disbursed among 6,985 recipients under this scheme. Reflecting the growing demand for services sector activities, most of the loans granted under the Saubagya scheme were for service activities in the area of hotels and restaurants, health care and related services.

The Provincial Development Credit Scheme was initiated with the objective of providing capital for medium and long term projects in the SME sector disbursed Rs. 340 million to eligible projects. The highest number of loans under this scheme was disbursed for activities in the services sector, mainly covering trading, transportation and educational services followed by manufacturing industries. Meanwhile, Self Employment Promotion Initiative Loan Scheme (SEPI), aimed at providing financial assistance for the youth trained at recognized vocational training institutions in the country to commence self-employment projects, granted loans amounting to Rs. 47 million in 2012. These self-employment projects included welding shops, electronic repair centers, beauty care centers, and small-scale garment industries.

In addition to these schemes, Awakening North – Phase II Loan Scheme, Resumption of Economic Activities in the Eastern Province – Phase II, Sabaragamuwa Province Integrated Rural Development Project - Phase II, Post Tsunami Coastal Rehabilitation and Resource Management Programme and Construction Sector Development Project Loan Scheme actively disbursed financial assistance for SME sector development during the year. Altogether, the loan schemes implemented by RDD disbursed Rs. 4,139 million on SME sector development and this was an increase of 56 per cent when compared with previous year's performance.

### 23.3 Development of Conflict Affected Regions

RDD continued to focus on enhancing economic activities in the Northern and Eastern Provinces that were affected by the three decades of conflict which hindered the growth prospects of these Provinces. Two special loan schemes introduced by RDD for the two Provinces were extended as Awakening North – Phase II Loan Scheme and Resumption of Economic Activities in the Eastern Province – Phase II Loan Scheme. As in their phase I stages, these two loan schemes also provide financial assistance for the resumption of economic activities in agriculture, livestock, fisheries, micro and small enterprises, and trade and other self-employment projects in the two Provinces. Under the Awakening North – Phase II Loan Scheme, 5,546 loans amounting

to Rs. 668 million have been granted by the PFIs while 3,612 beneficiaries received loans amounting to Rs. 528 million under Resumption of Economic Activities in the Eastern Province – Phase II Loan Scheme. In addition, Repair of Damaged Houses in the North and East Loan Scheme disbursed Rs. 84 million to the housing sector development in 2012.

Furthermore, with the peaceful atmosphere that prevailed during the year, the other development loan schemes also performed well in the Northern and Eastern Provinces. The agricultural credit schemes, especially NCRCS, provided credit facilities in the two provinces and performed a significant role in boosting up of agricultural activities in the two provinces. Saubagya Loan scheme and Provincial Development Loan Scheme, the two schemes that provide assistance for SME sector development were active in the two Provinces during the year. RDD also targeted to reach poor households in the two Provinces under the Poverty Alleviation Microfinance Project II (PAMP II) with the assistance of PFIs during the year.

### 23.4 Poverty Alleviation

The poverty alleviation strategy of the RDD focuses on reaching the people who were excluded from the formal financial sector as well as to literate them in financial management and providing them loans to commence income generating activities. In this exercise, RDD also expects to build up sustainable micro finance networks in the regions.

Poverty Alleviation Micro-finance Project II (PAMP II) continued to operate in 14 districts in the country in 2012. The objective of this project is to improve income level of the poor by absorbing them into the formal financial sector to provide credit for their income generating activities and train them on skills development thereby contributing to alleviate poverty, reduce regional disparities and supporting peace building. During the year, 10,116 beneficiaries had been granted loans to the value of Rs. 652 million to commence income generating activities. In the meantime, Poverty Alleviation Microfinance Project - Revolving Fund Loan Scheme also disbursed Rs. 387 million among 9,612 recipients to commence income generating activities. Of the total loan amount of the two schemes, 46 per cent were disbursed for trading and other services while small industries (19 per cent), livestock (15 per cent) and agriculture (13 per cent) followed.

Meanwhile, the Small Farmer and Landless Credit Project - Revolving Fund Loan Scheme (SFLCP-RF), that intends to improve economic wellbeing and general welfare of the rural poor, also progressed in 2012 by granting of loans to the value of Rs. 180 million among 5,704 beneficiaries. The Small Holder Plantation Entrepreneurship Development Programme, which provides financial assistance to marginalised small holders in selected Divisional Secretary Divisions in Kandy, Kegalle and Nuwara-eliya Districts and poor upland food crop farmers in the intermediate zone of



Monaragala District and the Dry Zone Livelihood Support and Partnership Programme, aimed at improving the livelihoods of farmers in Aanuradhapura, Badulla, Monaragala and Kurunegala Districts also disbursed micro finance facilities under Self Help Group system.

### 23.5 Promoting Awareness

In order to promote financial inclusiveness among the financially excluded people in the regions, RDD conducted 140 financial literacy programmes. These programmes, which were conducted with the assistance of PFIs, enhanced the awareness on financial management at household level, risk on dealing with unauthorized financial institutions and availability of financial products/services at formal financial institutions. Further, RDD facilitated Training of Trainers (TOT) sessions for bankers in the regions with the help of outsourced training officers with a view of increasing the level of financial inclusiveness among the target groups in the regions.

RDD also conducted 42 entrepreneurship development programmes and project appraisal workshops for selected SME sector entrepreneurs to create awareness on the availability of financial facilities and that of technical and marketing knowhow facilities from relevant Institutions. Meanwhile, RDD arranged 10 Seminars for SME sector entrepreneurs with the participation of technical experts to impart their knowledge on modern technology, quality improvements, marketing, management and accounting practices. In addition, 8 pre and post-harvest technology seminars were conducted for farmers in 2012 to enhance awareness on quality and to increase productivity among farmers.

### 24. SECRETARIAT

The Secretariat Department (SD) was one of the first departments established at the inception of the Bank, with the objective of providing overall facilities and services required for its operations. Its functions mainly involve with the procurement of goods and services, formulation and implementation of leave policies, administration of superannuation funds, provision of travel and other general services and legal services.

In 2012, the Secretariat Department continued to facilitate efficient functioning of the CBSL through timely procurement of goods and services, continuous assessments and upgrading of the operational systems and procedures, administering and implementing rules and regulations in respect of leave, superannuation funds and general services.

The SD procured capital and non-capital goods and services amounting to Rs179.6 million during the year, mainly through tenders by assuring and maintaining quality, timeliness, and competitive prices. As in the past, procurement planning was continued further to monitor the procurement management process of

the CBSL in order to streamline the timely supply of goods and services to the user departments. As a result the SD was able to complete 90 percent of the total procurement requirements of the Bank planned for the year. In addition, the SD obtained a cost effective and comprehensive insurance cover for all CBSL properties. SD administered the Central Bank Pension Scheme, Widows' and Orphans' Pension Fund (W & OP) and Widowers' and Orphans' Pension Fund (WR & OP). The total number of pensioners enrolled under these schemes was 2,048, at the end of 2012.

During the year, SD continued to provide the Bank with legal services. Such services were made available in a wide array of activities ranging from routine legal issues to policy formulation so as to catalyze the activities of the Bank. In handling litigation, a proactive role was played to assert and defend the rights of the Bank. In order to facilitate smooth handling of diverse challenges before the Bank, necessary assistance was provided by preparing suitable laws and by laws in respect of the banking and financial sector.

In 2012, the SD coordinated and organized various religious and commemorative events and annual ceremonies such as long service award ceremony and Independence Day ceremony.

### 25. SECURITY SERVICES

The Security Services Department (SSD) took adequate measures to strengthen the security of employees, visitors and property of the Central Bank of Sri Lanka (CBSL) including currency consignment in transit with the cooperation of the Security Forces and Police, in year 2012.

In performing duties under the above responsibility, SSD ensured the smooth clearance of employees, visitors and material by further improving the automated Visitor Monitoring and Management System which was introduced to the Head Office during the year 2011. Action was also initiated to install a latest Centralised Integrated Access Control System to the Head Office of the CBSL. SSD further installed an Access Control System and Fire Fighting System at Lloyds Building, Baron Jayatilake Mawatha, Colombo 01, new location of the Employees' Provident Fund.

SSD consists of a permanent cadre recruited from Security Forces and Police and supplemented by outsourced private security. During the year 2012, SSD was able to recruit 15 young security officers mainly to fill the vacuum due to retirement and also to maintain an average age and to enhance the security of provincial offices located outside Colombo. These new recruits were given a 02 week comprehensive training on commercial security before they were employed on CBSL duty. To gain knowledge on latest techniques, selected staff officers from the SSD were sent to Malaysia for

Advanced Commercial Security Training and Leadership Training. Fifty six security officers were educated on VIP escorts, investigations and report writing with the assistance of Sri Lanka Police to help in their day to day activities. Another 06 staff officers and 105 non staff officers were sent for various training programmes on commercial security and other administrative training conducted locally to upgrade their competency skills. Sri Lanka Army conducted weapon and live fire training for all security officers of the CBSL during the year 2012. Further, staff of SSD participated in all business continuity planning drills of the CBSL.

With the assistance of Sri Lanka Air Force, Colombo Fire Brigade and St. John Ambulance, a two day training programme on fire fighting and first aid treatment was arranged for 92 employees selected from different departments of CBSL as fire wardens with a view to obtain assistance in case of an emergency and also to impart knowledge to their departmental colleagues.

With the above additions, improvements, and developments of its human resources, SSD ensured CBSL Head Office and its branches continue its usual business without any security related threat during the year 2012.

## 26. STATISTICS

In recognition of the need to expand the collection and analysis of statistics in Sri Lanka, the Statistics Department was established in 1978 to perform the functions broadly classified as social accounts, sample surveys and econometric models. Since then, the work of the Statistics Department has evolved into its present functions of forecasting and estimating key macroeconomic variables, compiling price and wage indices, the Sri Lanka Prosperity Index and the Provincial Gross Domestic Product, conducting surveys, collecting and processing data through the Country Wide Data Collection System, timely dissemination of statistics and information through publications and press releases and improving the Doing Business Ranking of Sri Lanka.

### 26.1 Forecasting Key Macroeconomic Variables

To assist monetary policy formulation, the Statistics Department prepares short-term forecasts of consumer price inflation and economic growth which are submitted to the Monetary Policy Committee and the Monetary Board. With regard to the inflation forecast, movements of consumer prices of goods and services in the Colombo Consumers' Price Index (CCPI) compiled by the Department of Census and Statistics (DCS) are monitored continuously and monthly CCPI forecasts (upto one year) are prepared based on past and future price developments and econometric techniques. Annual and quarterly forecasts of GDP (output) growth with sectoral composition are prepared based on data collected from primary and secondary sources and in liaison with DCS. In addition, forecasts of other national

income accounts components such as consumption, investment and savings are also prepared annually.

### 26.2 Compiling Price and Wage Indices

The Statistics Department continued to compile Provincial Consumer Price Indices (PCPI) to monitor consumer price movements at provincial level. The PCPIs are based on the Consumer Finance and Socio-economic Survey (CFS) of 2003/04 conducted by the department. Price data for the PCPIs were collected through the Country Wide Data Collection System (CWDCS). Accordingly, PCPIs for the nine provinces and the All-Island Consumer Price Index were compiled on a monthly basis in 2012.

The Statistics Department also continued to compile the Wholesale Price Index (WPI) to monitor prices at the primary market level, on a monthly basis. Data for the WPI is also collected through CWDCS. In view of the need for a more updated and representative price index to measure price developments at the producer level, the DCS with the assistance of the Statistics Department commenced the construction of a Producer Price Index (PPI) and initially it will be compiled for the agriculture sector.

In order to assess the movements of salaries and wages in the economy, the Statistics Department compiles wage rate indices for public sector employees and formal private sector employees. The Public Sector Wage Rate Indices covers non-executive officers and minor employee grades in the central government and the government school teachers. A Minimum Real Wage Index for Formal Private Sector employees based on the Minimum Wage Rate Indices compiled by the Department of Labour was computed by the department. In addition, information on daily wages of Informal Private Sector workers covering agriculture and building construction was collected through the CWDCS. A quarterly report on wage rate trends based on the above mentioned data was prepared.

Rapid movements in real estate prices could have a significant impact on the economy. In order to facilitate monitoring land prices the Statistics Department compiles Land Price Indices (LPI) using land price data collected by the Valuation Department from five Divisional Secretary Divisions (DS) in the Colombo District. In view of the diverse nature of land usage and to maintain homogeneity, three types of indices - residential, commercial and industrial were compiled for the period from 1998 to 2012. The LPIs are computed on a biannual basis.

### 26.3 Compiling the Sri Lanka Prosperity Index

The Sri Lanka Prosperity Index (SLPI) was introduced by the Central Bank in 2008 in order to fulfill the need for a composite indicator to assess the overall status of prosperity in the country as a whole and in each of its provinces. The SLPI is a multi-dimensional indicator reflecting the economic and social developments in the

country and the provinces. The SLPI is comprised of three sub-indices, namely, Economic and Business Climate, Well-Being of the People and Social Infrastructure and the overall index contains 26 variables. The SLPI is compiled by the Statistics Department on an annual basis and the SLPI for the period 2009 to 2011 was published in 2012.

#### **26.4 Computation of the Provincial Gross Domestic Product**

The Provincial Gross Domestic Product (PGDP) in nominal terms for 2011 was computed by the Statistics Department based on the disaggregation of the GDP estimated by the DCS. The PGDP for the nine provinces is computed on an annual basis and was published in 2012.

#### **26.5 Statistical Surveys**

The Inflation Expectations Survey which was initiated in 2006, was conducted by the Statistics Department on a monthly basis. The survey covers around 300 respondents from financial institutions, public sector institutions, schools and retail outlets. Responses are collected through e-mails and interviews. Respondents provide both quantitative and qualitative information on current inflation perceptions and expected inflation for the future 12 month period. The results of each month's survey were reported to the Monetary Policy Committee and the Monetary Board.

The Annual and Quarterly Public Sector Employment Surveys (QPSES) which were initiated in 2001 were conducted by the Statistics Department during the year to ascertain the levels and trends of public sector employment in the country. This data is also used for national income estimates. The quarterly survey covered all Central Government, Local Government and Semi-government institutions with over 1,000 employees each as reported in the Annual Public Sector Employment Survey (APSES) of 2011.

Information collected on the labour force based on the Quarterly Labour Force Surveys conducted by the DCS and the labour market covering the areas of foreign employment, labour relations, labour market reforms and labour productivity were also analysed by the Statistics Department.

The Statistics Department conducted a special survey on vegetable production and prices, covering the Special Economic Centres in Dambulla, Nuwara-Eliya and Embilipitiya. The main objective of the survey was to identify the factors affecting the supply chain of vegetable production and inherent volatilities associated with vegetable prices. Policy proposals were made based on the findings of the survey.

#### **26.6 Country-Wide Data Collection System**

The Country-Wide Data Collection System (CWDCS) which commenced in 1978, continued to operate

through an island-wide network of government school teachers who function as statistical investigators for 102 data collection centres, including 19 data collection centres in North and East. Under this system, information on retail prices of consumer goods, producer prices of agricultural commodities, daily wages pertaining to the informal private sector and future production levels of major agricultural produce was collected. In addition, wholesale and retail prices of major food items were collected by non-teacher investigators from the Pettah market and other centres such as the Marandagahamula rice market and the Dambulla and Narahenpita Special Economic Centres.

Data collected under the system is used for the compilation of price indices, forecasting price movements, evaluation of the impact of policy changes on prices and estimation of national expenditure and income. The data collection process was improved during the year, by introducing updated formats for data collection to accommodate recent market developments and economic activities that has emerged in the economy. The quality and timeliness of data collection was further strengthened through regular on-site and off-site supervision and continuous monitoring of the data forwarded by the investigators. In addition, accuracy of this data was further verified in comparison with the data collected from selected markets in the Colombo district, by officers of the Statistics Department. Supervision activities of selected data collection centers which are located within the purview of the Central Bank's Provincial Offices (PO) were carried out by the respective POs, with a view to further strengthening the CWDCS.

Furthermore, five regional seminars were conducted in Colombo, Matara, Anuradhapura, Kandy and Jaffna in 2012 to provide guidance for data collectors. These seminars provided an opportunity to develop a rapport with the teachers, to share experiences, get feedback and to discuss issues relating to the operation of the programme. These discussions provided refresher training to the investigators in order to improve the accuracy, quality, efficiency and timeliness of their data collection and to obtain views on the differences in price developments across regions identified in the computation of the provincial price indices. The seminars also included special educative sessions on current developments in the economy.

The Early-Warning System (EWS), which was initiated in 2011 using the CWDCS to collect information on production levels of selected crops, was used to improve projections of inflation and GDP in 2012. The sources of information under the EWS was expanded by including government officials, major producers, regional chambers, POs and vendors during the year. The reporting system was further improved by assigning weights for each produce in accordance with the contribution of different districts for the cultivation of the respective crop.

## 26.7 Improving the “Ease of Doing Business” Ranking

Since 2009, the Statistics Department has been engaged in an exercise to improve Sri Lanka’s “Ease of Doing Business” ranking. For this purpose the department carried out several key activities in 2012. These activities included organizing bi-annual seminars with the patronage of the Hon. Minister of Economic Development and the participation of Secretaries of relevant Ministries and key officials to formulate strategies to improve the “Ease of Doing Business” ranking and future strategies that need to be adopted to improve the ranking further in the medium term, organizing discussions with the participation of the key stakeholders and the data providers with a view to facilitate a common platform for the key stakeholders to inform the data providers on the areas where reforms have been implemented with respect to their organizations and procedures, conducting a number of video conference meetings to enable the key stakeholders to directly discuss with the World Bank Head Office in Washington the reforms which has been done and to clarify issues and submitting reports on reforms and issues to the World Bank. As a result, Sri Lanka improved its ranking to 81 for 2013 from 89 for 2012 on account of improvements in the areas relating to starting a business, registering property, getting credit and paying taxes. Sri Lanka is the second most improved country in terms of reform progress and highest ranked country in South Asia.

The Statistics Department also published the 3rd edition of the ‘Step by Step Guide to Doing Business in Sri Lanka’ in 2012 making appropriate revisions to the booklet in order to provide the most up to date information on current regulations and other relevant information to the investor community.

## 26.8 Dissemination of Statistics

The Statistics Department is responsible for disseminating a wide range of socio-economic data of current interest to policy makers, researchers, academics, professionals, students and the general public. During the year, the Statistics Department released its two main annual publications titled “Economic and Social Statistics of Sri Lanka 2012 – Volume XXXIV” for the first time in all three (03) languages in April 2012 and “Sri Lanka Socio Economic Data Folder 2012 – Volume XXXV” in June 2012. In addition, it published the Weekly and Monthly Economic Indicators in 2012. The Statistics Department contributes two chapters to the Central Bank Annual Report and Recent Economic Developments and makes regular contributions to the Monthly Bulletin. The Statistics Department also issues a monthly press release on headline and core inflation analyzing price developments of the items in the CCPI. Further, the prices of selected food commodities obtained from the DCS were also reported weekly to the Ministry of Economic Development for policy purposes. The department webpage - StaNet on the local area net work and the CBSL website were also updated on a regular basis.

## 27. SUPERVISION OF NON-BANK FINANCIAL INSTITUTIONS

The Department of Supervision of Non-Bank Financial Institutions (Department) was established in 1988 to regulate and supervise Licensed Finance Companies (LFCs). As at that time, the Finance Companies Act No.78 of 1988 (FCA) had been enacted replacing the Control of Finance Companies Act, No.27 of 1979 (CFCA) and the Department was assigned with the responsibility of enforcement of the provisions of the FCA. With a view to further strengthen the regulation and supervision of LFCs and to curb unauthorized deposit taking businesses, the Finance Business Act (FBA), No.42 of 2011 was enacted repealing and replacing FCA, and became effective from 09.11.2011. In August 2000, the Finance Leasing Act, No.56 of 2000 (FLA) was enacted to provide for the regulation and monitoring of finance leasing business also under this Department and this Act came into operation with effect from 01.08.2001. Further, the task of establishing a regulatory and supervisory mechanism for the micro finance sector has also been vested to this Department.

### 27.1 Functions

The supervisory responsibilities of the Department include licensing of companies to carry on finance and specialized leasing business, formulating and implementing prudential requirements, conducting continuous supervision and periodic on-site examinations, granting regulatory approvals, investigating and taking legal action on entities conducting finance business without authority and conducting of public awareness programmes to educate the general public on the risk of depositing with unauthorised financial institutions.

As at end 2012, there were 47 LFCs and 76 Registered Finance Leasing establishments (RFLEs) comprising of 13 Licensed Commercial Banks (LCBs), 6 Licensed Specialised Banks (LSBs), 44 LFCs and 13 Specialised Leasing Companies (SLCs) in operation. LFCs and SLCs together is referred to as Non-Bank Financial Institutions (NBFIs). The names of these LFCs and RFLEs are provided in Annex II-3.

### 27.2 Activities during the Year

#### (a) Supervision of NBFIs

##### (i) Off-site Surveillance of NBFIs

Continuous off-site surveillance was carried out for all NBFIs by analysing financial information received through periodic returns submitted by NBFIs. Corrective actions are proposed based on the findings of these off-site surveillance examinations.

The Department introduced an Early Warning and Follow up System to identify potential risk areas and to propose remedial actions to be implemented in LFCs in order to mitigate such risks. Further, an

internal rating system also has been implemented to rank NBFIs based on their financial strength.

## (ii) On-site Examination of NBFIs

Periodic on-site examinations were carried out to assess the liquidity, asset quality, capital adequacy, management efficiency, earnings, profitability, system controls and the status of corporate governance of NBFIs. A risk based approach was adopted in carrying out these examinations where the focus was on identification of risks, management of risks and assessment of resources to mitigate such risks. During 2012, the Department conducted on-site examinations of 17 LFCs and 6 SLCs. The examination reports highlighting any risks identified and recommendations for corrective actions were provided to the respective Boards of Directors.

In addition, 7 LFCs and 2 SLCs were examined on a limited scope basis concentrating on weaker areas.

## (b) Issue of Directions and Prudential Requirements

New prudential requirements and directions were introduced with the approval of the Monetary Board to NBFIs.

### (i) Regulations to LFCs

- **Information Systems Security Policy:** Information systems have become significantly important for the strategic operations and risk management of LFCs. A direction was issued stipulating the minimum requirements of an Information Systems Security Policy.
- **Interest Rates:** Interest rates direction for finance companies was revised to reflect the changes in the market interest rates.
- Two rules were issued to LFCs namely; application rule with changes on application procedure for licensing under the FBA and revised licensing fees.

### (ii) Regulations to SLCs

- **Introduction of assessment of fitness and propriety of directors and officers performing executive functions:** Fitness and propriety of directors and officers performing executive functions is a key requirement to ensure good governance and risk management on conduct of business of NBFIs which promotes the stability of such companies. Accordingly, all directors and officers performing executive functions are required to submit affidavits and declarations with respect to their fitness and propriety to hold such positions in SLCs.

- **Minimum core capital:** With a view of promoting the financial soundness, SLCs were required to maintain a minimum core capital. This direction revised the definition of the core capital used by the SLCs to be in line with the definition of core capital under the BASEL II framework.
- **Gearing ratio:** SLCs were required to use the core capital as the yardstick for the computation of gearing ratio instead of capital funds, as capital funds comprise a wider range of reserves including revaluation reserves.
- **Introduction of liquid assets requirement:** This direction revised the existing total liabilities and off balance sheet amounts used to compute the liquidity requirement by excluding liabilities to the shareholders, asset-backed long term borrowings and securitization in SLCs.

### (iii) Regulations to NBFIs

- **Panel of external auditors:** A panel of external auditors was appointed to conduct audits of NBFIs. The panel was issued with guidelines to ensure a greater degree of consistency and establish standard procedures of audits of NBFIs.

## (c) Regulatory Approvals

During 2012, the total number of LFCs increased from 39 to 47 with four SLCs namely; Nation Lanka Finance PLC, Orient Finance PLC, People's Leasing and Finance PLC and People's Merchant Finance PLC elevating to LFC status. In addition four companies obtained licences under the FBA namely; Deshodaya Development Finance Co. Ltd., Ideal Finance Ltd, Melsta Regal Finance Ltd. and Richard Peiris Arpico Finance Ltd. Meanwhile five new institutions were registered under the FLA namely; Sri Lanka Savings Bank Ltd., Newest Capital Ltd., TKS Finance Ltd., Ideal Finance Ltd. and Melsta Regal Finance Ltd. Accordingly, the total number of RFLEs increased to 76 during the year.

### (d) Meetings with the NBFi Sector

The meetings chaired by the Governor of the Central Bank of Sri Lanka with the Chief Executive Officers (CEOs) of NBFIs were held on a quarterly basis with a view to exchange views on issues relating to the sector.

Further, a meeting for Chairmen of NBFIs, chaired by the Governor of the Central Bank of Sri Lanka was held to appraise the importance of compliance with the prudential directions and to increase awareness on regulatory requirements and best practices.

- The Department conducted its annual Symposium for Directors and CEOs of NBFIs under the theme "Positioning the Non-Banking Sector for the Post \$4K Era".

**(e) Business Revival Plan of Distressed NBFIs**

The Department continued to closely monitor the performance of the 7 distressed companies affected by the liquidity crisis in 2008, through off-site supervision and regular meetings with Boards of Directors and senior management.

**(f) Other Activities****(i) Follow up of the Finance Business Act**

The FBA was enacted on 09.11.2011 by repealing and replacing the Finance Companies Act, No.78 of 1988. The Department conducted several public awareness programmes island wide and published a series of paper advertisements to educate the public with regard to the salient features of the FBA.

**(ii) The Proposed Microfinance Act**

The Monetary Board in March 2012 decided to reconsider consolidating the microfinance sector under the Central Bank of Sri Lanka considering the expertise and experience available. The Department prepared a draft Microfinance Act which is expected to be enacted during 2013.

**(iii) Investigation on Conduct of Finance Business without Authority**

During 2012, the Department commenced investigations on seven persons/institutions under section 42 of the FBA. Further, 22 examinations were concluded. The Department regularised activities of one institution while initiating legal actions against three institutions during the year.

In order to strengthen the investigation on unauthorised finance business and accepting deposits without authority, the Department introduced a comprehensive and uniform procedure to be followed during investigation, determination and prosecution of unauthorised finance businesses.

**(iv) Technical session to the NBFIs**

The Department conducted two technical sessions on International Financial Reporting Standards (IFRS) and risk management for the senior management of NBFIs. Further, two workshops on information systems security and business of pawning and gold loans were organised to the middle management of NBFIs.

**(v) Adoption of IFRS**

A subcommittee was setup with representatives from the Institute of Chartered Accountants of Sri Lanka, Leasing Association of Sri Lanka (LA), the

Finance Houses Association of Sri Lanka (FHA) and the Central Bank of Sri Lanka to evaluate and facilitate the application of Sri Lanka Accounting Standards (SLFRS/LKAS) to the NBFIs sector. The FHA and LA have communicated the finalized NBFIs sector specific accounting treatments. The Department is expected to issue a guideline on areas where the SLFRS/LKAS and Central Bank of Sri Lanka directions differ.

**27.3 Contribution to the Public****(a) NBFIs Sector Growth and Stability**

The Department continued to take measures to ensure stability of the NBFIs sector. Further, the Department has granted approvals for opening of new branches covering all the regions in the country, enhancing financial inclusion. The assets base of the sector grew by 22 per cent supported by a healthy growth in funding sources with deposits and borrowings recording growth rates of 37 per cent and 3 per cent respectively. Accommodations grew by 21 per cent. The NBFIs sector recorded after tax profit of Rs.15 billion (unaudited) for the twelve month period ended 31.12.2012. The total capital adequacy ratio remained robust at a rate of 16 per cent. The non-performing accommodations ratio has declined marginally to 5.0 per cent from 5.1 per cent. Further, the Department continued its effort in reviving distressed companies to ensure safety of public deposits.

**(b) Public Awareness Programmes**

**(i) Awareness programmes:** Educating the public of the risk of investing in unauthorised finance business was done through public awareness programmes. 26 public awareness programmes were conducted in Kandy, Matale, Nuwara Eliya, Trincomalee, Puttlam, Badulla and Matara Districts with the focus on rural areas.

**(ii) Radio and television programmes:** Participated in four "Subharathiya" programmes conducted by the Sri Lanka Broadcasting Corporation while broadcasting special messages to the public through the special transmission conducted by the Kandurata Service of the Sri Lanka Broadcasting Corporation at the "Esala Perahera" Kandy. Telecast two TV commercials in both Sinhala and Tamil through selected TV channels.

**(iii) Leaflets and newspaper articles:** 1,550 posters containing lists of Licensed Banks and LFCs have been distributed among Grama Niladharies in Puttlam and Badulla Districts. 33,000 leaflets containing lists of Licenced Banks and LFCs with other useful information were distributed among the general public. The list of institutions authorised

to accept deposits were published on a quarterly basis in the newspapers in all three languages. All the aforesaid activities have helped to enhance the financial literacy among the public II-3.

### (c) Attending to Public Complaints

The Department initiated actions to resolve complaints received with regard to NBFIs from the general public, continuously. Such complaints have been directed to respective NBFIs and actions have been followed up.

## Annex II-3

## Licensed Finance Companies and Registered Finance Leasing Establishments

### Institutions licensed with the Central Bank of Sri Lanka in accordance with the law (As at end 2012)

Licensed Finance companies	Registered Finance Leasing Establishments
1. Abans Finance PLC	<b>(A) Licensed Commercial Banks</b>
2. Alliance Finance Co. PLC	1. Amana Bank Ltd
3. AMW Capital Leasing and Finance PLC (formerly, AMW Capital Leasing PLC)	2. Bank of Ceylon
4. Arpico Finance Co. PLC	3. Commercial Bank of Ceylon PLC
5. Asia Asset Finance PLC (formerly, Asia Asset Finance Ltd)	4. DFCC Vardhana Bank PLC
6. Asian Finance Ltd	5. Hatton National Bank PLC
7. Associated Motor Finance Co. PLC	6. MCB Bank Ltd
8. Bartleet Finance PLC	7. National Development Bank PLC
9. Bimpuh Finance PLC (formerly, Bimpuh Lanka Investments PLC)	8. Nations Trust Bank PLC
10. Capital Alliance Finance PLC	9. Pan Asia Banking Corporation PLC
11. Central Finance Co. PLC	10. People's Bank
12. Central Investments and Finance PLC	11. Sampath Bank PLC
13. Chilaw Finance PLC (formerly, Chilaw Finance Ltd)	12. Seylan Bank PLC
14. Citizens Development Business Finance PLC	13. Union Bank of Colombo PLC
15. City Finance Corporation Ltd	<b>(B) Licensed Specialised Banks</b>
16. Commercial Credit and Finance PLC (formerly, Commercial Credit PLC)	1. DFCC Bank
17. Commercial Leasing & Finance PLC (formerly, Commercial Leasing & Finance Ltd)	2. Lankaputhra Development Bank Ltd
18. Deshodaya Development Finance Co. Ltd	3. MBSL Savings Bank Ltd
19. ETI Finance Ltd (formerly, Edirisinghe Trust Investments Ltd)	4. Pradeshiya Sanwardana Bank
20. George Stewart Finance PLC (formerly, Divasa Finance Ltd)	5. Sanasa Development Bank PLC
21. Ideal Finance Ltd	6. Sri Lanka Savings Bank Ltd
22. Kanrich Finance Ltd	<b>(C) Specialised Leasing Companies</b>
23. L B Finance PLC	1. Assetline Leasing Co. Ltd
24. Lanka ORIX Finance PLC	2. Ceylease Ltd (Formerly, Ceylease Financial Services Ltd)
25. Melsta Regal Finance Ltd	3. Co-operative Leasing Co Ltd
26. Mercantile Investments and Finance PLC (formerly, Mercantile Investments PLC)	4. Indra Finance Ltd
27. MCSL Financial Services Ltd (formerly, Merchant Credit of Sri Lanka Ltd)	5. Isuru Leasing Co. Ltd (Formerly, Isuru Finance Co. Ltd)
	6. Koshiba Leasing Co. Ltd
	7. Lisvin Investments Ltd
	8. LOLC Micro Credit Ltd
	9. Merchant Bank of Sri Lanka PLC
	10. Newest Capital Ltd
	11. Sampath Leasing & Factoring Ltd
	12. SMB Leasing PLC
	13. Softlogic Credit Ltd

<ul style="list-style-type: none"> <li>28. Multi Finance PLC</li> <li>29. Nanda Investments and Finance PLC (Formerly, Nanda Investments and Finance Ltd)</li> <li>30. Nation Lanka Finance PLC</li> <li>31. Orient Finance PLC (formerly, Orient Financial Services Corporation Ltd)</li> <li>32. People's Finance PLC</li> <li>33. People's Leasing and Finance PLC (formerly, People's Leasing Co. PLC)</li> <li>34. People's Merchant Finance PLC (formerly, People's Merchant PLC)</li> <li>35. Prime Grameen Micro Finance Ltd</li> <li>36. Richard Peiris Arpico Finance Ltd</li> <li>37. Senkadagala Finance PLC</li> <li>38. Singer Finance (Lanka) PLC</li> <li>39. Sinhaputhra Finance PLC</li> <li>40. Softlogic Finance PLC</li> <li>41. Swarnamahala Financial Services PLC</li> <li>42. The Finance Co. PLC</li> <li>43. The Standard Credit Finance Ltd (formerly, The Standard Credit Lanka Ltd)</li> <li>44. Trade Finance &amp; Investments PLC</li> <li>45. TKS Finance Ltd</li> <li>46. U B Finance Co. Ltd (formerly, The Finance &amp; Guarantee Co. Ltd)</li> <li>47. Vallibel Finance PLC</li> </ul>	<p><b>(D) Licensed Finance Companies listed above except Prime Grameen Micro Finance Ltd, Richard Pieris Arpico Finance Ltd and Deshodaya Development Finance Co. Ltd</b></p>
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## 28. WELFARE

The Welfare Department (WD) continued to extend welfare facilities to all beneficiaries in an efficient and effective manner throughout the year. Functions of WD include providing loans under the Staff Housing (Mortgage) Loan Scheme, Provident Fund Loan Scheme and Staff Benefit Scheme, reimbursement of expenses under the Medical Benefit Scheme and provisions of restaurant facilities. The registered beneficiaries of WD are approximately 11,000 consisting of employees, pensioners, widows/widowers and their registered dependents.

During the year 2012, WD granted 2,008 loans which included Provident Fund Loans, Vehicle Loans, Computer Loans and other loans under the Staff Benefit Scheme and Housing Loans. These loans were granted within a stipulated time frame after the submission of the application with all relevant documents. The welfare loan scheme was simplified during the latter part of the year to address the administrative difficulties and reduce operational costs. Further, the loan monitoring system enabled the disbursement of loans to employees accurately in an expeditious manner.

The CBSL restaurant continued providing breakfast and lunch to the CBSL staff as well as the staff of other institutions located in the Bank's premises. The tea service provided by WD was diversified by adding herbal drinks as evening refreshment twice a week. Actions were taken to enhance the pleasant environment of the restaurants and improve the restaurant facilities during 2013.

WD continued to reimburse medical expenditure incurred by all registered beneficiaries under the Medical Benefit Scheme (MBS). The increase of limits under the MBS with effect from January 01, 2012 resulted in the increase of reimbursed medical expenditure by 33 per cent compared to the previous year. Medical facilities at the Medical Centre were made available to the CBSL employees during working hours by outsourcing such services to a reputed private hospital. Further, laboratory services too were provided at the Medical Centre at a reasonable price. During the year under reference, WD conducted an eye camp and six awareness programmes to enhance the knowledge of the CBSL staff. A survey too was conducted among CBSL employees to get their feedback in order to further improve the services provided by WD.