

PART II

PART II

ACCOUNTS AND OPERATIONS OF THE CENTRAL BANK OF SRI LANKA

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1. ACCOUNTS AND FINANCE

Activity Report of the Monetary Board Advisory Audit Committee for the Year 2017

1. Introduction

The Monetary Board Advisory Audit Committee (AAC) is a subcommittee of the Monetary Board. The Committee advises the Monetary Board on policies and matters relating to the financial reporting, internal controls and risk management systems, compliance, whistleblowing and fraud, internal audit, external audit and any other matter assigned by the Monetary Board. The AAC reports its recommendations and performance to the Monetary Board for consideration on a quarterly basis and as and when necessary.

2. Composition of AAC

The AAC is chaired by an appointed member of the Monetary Board and comprised of two other external audit professionals. The Secretary to the Monetary Board is the Secretary to the AAC and the Director of the Internal Audit Department is the Assistant Secretary to the AAC. The Internal Audit Department (IAD) provides secretarial facilitation to the AAC. Audit Superintendent in charge of the external audit of the Central Bank of Sri Lanka (CBSL) conducted by the Auditor General, attends AAC meetings as an observer. Other regular attendees of the AAC Meetings are Assistant Governor supervising the Finance Department and Compliance Officer of the Bank as observers and relevant staff of the Internal Audit Department to facilitate the Director of the IAD. Heads of Department are invited by the Chairman of the AAC as and when necessary to provide input and clarification. The engagement partner of the Audit Firm appointed by the Auditor General to carry out the external audit also attends when the financial statements of the Bank are discussed.

The composition of the Committee as at 31.12.2017 was as follows:

- i. Mr. A N Fonseka - Chairman
- ii. Mr. H M A Jayasinghe - Member (with effect from 15.08.2017)

Monetary Board extended the terms of Mr. M R Mihular and Mrs. A M J Patrick from 31.12.2016 until the appointment of Mr. H M A Jayasinghe. The Monetary Board has approved the appointment of a new member in place of Mrs. Patrick.

The Committee is required to meet at least six (06) times a year or as may be decided by the Chairman of the AAC or as directed by the Monetary Board. Meetings of the Committee are convened by the Secretary to the Committee. A quorum of two (02) members including the Chairman is required for a meeting.

3. Activities carried out in 2017

The AAC held six (06) meetings during 2017 and made recommendations relating to the following.

a) Financial reporting and external Audit:

The Committee,

- i. reviewed the Interim Issue Memorandum on the audit of Financial Statements of the CBSL for the period ended 30.09.2016 and made recommendations to the Monetary Board.
- ii. reviewed the Report of the Auditor General on the Financial Statements of the CBSL for the year 2015.
- iii. reviewed the Management Letter of the External Auditor for the year 2016 and made recommendations.
- iv. discussed the transitioning to International Financial Reporting Standard 9 (IFRS 9) – Financial Instruments.

b) Internal controls and risk management systems:

The Committee,

- i. reviewed the findings of the Internal Audit Department on Information Systems Security of the CBSL and directed the relevant persons to implement the recommendations.

- ii. reviewed and advised on the adequacy and effectiveness of the internal controls and risk management systems and corrective actions that are required to be taken by the departments of the CBSL.

c) Internal audit:

The Committee,

- i. reviewed and recommended for approval of the Monetary Board for the Strategic Internal Audit Plan for 2018 - 2020 and the Annual Audit Plan for 2018, prepared by the IAD.
- ii. reviewed the implementation progress of the recommendations made to the Heads of Department on the observations made by the IAD.
- iii. reviewed the proposed methodology for risk assessment of audit universe.
- iv. reviewed the amendments to Audit Facilitation Guidelines and the resources of the IAD.

Central Bank of Sri Lanka

Management Statement

For the period ended 31 December 2017

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 KPMG, 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 அறிபதி திணைக்களம்
AUDITOR GENERAL'S DEPARTMENT



මගේ අංකය }
எனது இல. } BAF/H/CBSL/1/17/1
My No. }

ඔබේ අංකය }
உமது இல. }
Your No. }

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திகதி } 03 April 2018
Date }

The Honorable Minister of Finance and Mass Media,

Report of the Auditor General on the Financial Statements of Central Bank of Sri Lanka for the year ended 31 December 2017 in terms of Section 42 (2) of the Monetary Law Act (Chapter 422)

Opinion

The audit of the financial statements of Central Bank of Sri Lanka (“the Bank”), which comprise the statement of financial position as at 31 December 2017, and the statement of income, statement of other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies, was carried out under my direction in pursuance of provisions in Article 154(1) of the Constitution of the Democratic Socialist Republic of Sri Lanka read in conjunction with 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 this audit, I was assisted by a firm of Chartered Accountants in public practice to examine the compliance with International Financial Reporting Standards.

In my opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2017, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

Basis for Opinion

I conducted my audit in accordance with International Standards on Auditing (ISAs). My responsibilities under those Standards are further described in the Auditor’s Responsibilities for the Audit of the Financial Statements section of my report. I am independent of the Bank in accordance with the ethical requirements that are relevant to my audit of the financial statements in accordance with the code of ethics issued by Institute of Chartered Accountants of Sri Lanka, and I have fulfilled

අංක 306/72, පොල්දො පාර, බත්තරමුල්ල, ශ්‍රී ලංකාව, . - இல. 306/72, பொல்துறவு வீதி, பத்தரமுல்லை, இலங்கை. - No. 306/72, Polduwa Road, Battaramulla, Sri Lanka

+94-11-2887028-34

+94-11-2887223

oaggov@sltnet.lk

www.auditorgeneral.gov.lk



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கணக்காய்வாளர் தலைமை அலுவலர் திணைக்களம்
Auditor General's Department

my other ethical responsibilities in accordance with this requirements. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

Responsibilities of Monetary Board

Monetary Board of the Bank is responsible for the preparation and fair presentation of the financial statements in accordance with IFRSs, and for such internal control as Monetary Board determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, Monetary Board is responsible for assessing the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting.

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

Auditor's Responsibilities for the Audit of the Financial Statements

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

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

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.



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கணக்காய்வகம்
Auditor General's Department

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by Monetary Board.
- Conclude on the appropriateness of Monetary Board's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my auditor's report. However, future events or conditions may cause the Bank to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

I communicate with the Monetary Board regarding, among other matters the planed scope and timing of the audit and significant audits findings, including any significant deficiencies in internal control that I identify during my audit.

Report to Parliament

My report to Parliament in pursuance of provisions in Article 154 (6) of the Constitution will be tabled in due course.

A handwritten signature in black ink, appearing to read 'H.M. Gamini Wijesinghe'.

H.M.Gamini Wijesinghe

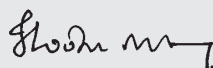
Auditor General

Central Bank of Sri Lanka Statement of Financial Position

As at 31 December

Assets	Note	2017 Rs. 000	2016 Rs. 000
Foreign Currency Financial Assets			
Cash & Cash Equivalents	5	459,827,641	423,783,737
Securities at Fair Value through Profit or Loss	6	45,264,376	43,278,755
Available for Sale Investments	6	566,228,935	348,544,650
Derivative Financial Instruments	7	4,940,455	198,880
IMF Related Assets	8	126,838,152	117,008,340
Other Receivables		3,670,494	6,175,049
Total Foreign Currency Financial Assets		1,206,770,053	938,989,411
Local Currency Financial Assets			
Sri Lanka Government Securities	9	32,080,086	351,426,470
Provisional Advances to Government	10	199,800,871	83,306,771
Loans to Banks	11	223,702	484,043
Equity Investments in Financial and Other Institutions	12	41,095	41,095
Other Assets	13	12,882,470	12,492,990
Total Local Currency Financial Assets		245,028,224	447,751,369
Total Financial Assets		1,451,798,277	1,386,740,780
Foreign Currency Non-Financial Assets			
Gold	14	126,583,727	111,009,339
Non-Financial Assets			
Inventories	15	6,875,533	6,114,861
Other Receivables and Prepayments		1,534,848	7,056,407
Property, Plant and Equipment	16	17,960,517	18,132,390
Intangible Assets	17	80,623	156,320
Total Non-Financial Assets		153,035,248	142,469,317
Total Assets		1,604,833,525	1,529,210,097
Liabilities and Equity			
Foreign Currency Financial Liabilities			
Banks and Financial Institutions	18	8,683,033	45,566,681
Derivative Financial Instruments	7	4,648,449	14,573,675
Asian Clearing Union	19	90,868,160	79,863,615
IMF	20	318,665,332	269,540,596
Others	21	64,095,889	96,250,032
Total Foreign Currency Financial Liabilities		486,960,863	505,794,599
Local Currency Financial Liabilities			
Deposits of Banks and Financial Institutions	22	341,712,198	303,251,290
Deposits of Government and Governmental Entities	23	324,517	450,884
Securities Sold Under Repurchase Agreements	24	40,655,278	70,054,436
Balances of Employee Benefit Plans	25	4,547	51,744
Currency in Circulation	26	598,053,901	552,777,865
Other Payables	27	8,887,156	8,563,548
Total Local Currency Financial Liabilities		989,637,597	935,149,767
Total Financial Liabilities		1,476,598,460	1,440,944,366
Other Liabilities			
Deferred Grants	28	45	80
Pension and Other Post Employment Benefit Plans	29	671,061	2,429,153
Miscellaneous Liabilities and Accruals	30	211,720	193,297
Total Other Liabilities		882,826	2,622,530
Total Liabilities		1,477,481,286	1,443,566,896
Equity			
Capital Funds		50,000,000	50,000,000
Reserves	31	77,352,239	35,643,201
Total Equity		127,352,239	85,643,201
Total Liabilities and Equity		1,604,833,525	1,529,210,097

The Governor and the Chief Accountant of the Central Bank of Sri Lanka authorised these financial statements for issue on 20th March 2018 for and signed on behalf of the Monetary Board.



Dr. Indrajit Coomaraswamy – Governor



U.L. Muthugala - Acting Chief Accountant

The accounting policies and notes on pages 11 through 60 form an integral part of the Financial Statements.

Central Bank of Sri Lanka			
Statement of Income			
For the year ended 31 December			
	Note	2017 Rs. 000	2016 Rs. 000
Operating Income :			
Income from Foreign Currency Financial Assets			
Interest Income	33	22,914,716	14,869,835
Gain from Unrealized Price Revaluations	34	24,000,475	9,739,043
Gain from Realized Price Changes		2,772,209	1,755,321
Total Income from Foreign Currency Financial Assets		49,687,400	26,364,199
Expenses on Foreign Currency Financial Liabilities			
Interest Expense	35	(2,963,231)	(3,953,835)
Total Expenses on Foreign Currency Financial Liabilities		(2,963,231)	(3,953,835)
Net Foreign Exchange Revaluation Loss		(3,808,147)	(6,775,246)
Foreign Currency Investment Income		42,916,022	15,635,118
Income from Local Currency Financial Assets			
Interest Income	33	18,768,928	21,020,691
Interest Expense	35	(2,676,116)	(2,197,815)
Total Income from Local Currency Financial Assets		16,092,812	18,822,876
Other Income	36	1,602,664	1,508,261
Total Net Operating Income		60,611,498	35,966,255
Operating Expenses:			
Personnel Expenses:	37		
— Salaries and Wages		(4,112,349)	(4,258,884)
— Defined Contribution Plan Costs		(610,489)	(629,786)
— Contribution to Post Employment Benefit Plan Costs		(744,356)	(1,479,963)
		(5,467,194)	(6,368,633)
Depreciation & Amortization		(518,716)	(520,961)
Cost of Inventory (Cost of new currency issue)		(2,850,823)	(3,076,747)
Administration and Other Expenses	38	(1,305,649)	(1,465,584)
Net Losses on Revaluation of Property, Plant and Equipment		-	(378,907)
Impairment Charges on Assets		(274,773)	(141,556)
Total Operating Expenses		(10,417,155)	(11,952,388)
Profit Before Tax		50,194,343	24,013,867
Withholding Tax	39	(1,837,976)	(1,834,348)
Profit for the Year		48,356,367	22,179,519

Figures in brackets indicate deductions

The accounting policies and notes on pages 11 through 60 form an integral part of the Financial Statements.

Central Bank of Sri Lanka

Statement of Other Comprehensive Income

For the year ended 31 December

Net Profit for the Year

Other Comprehensive Income (OCI)

Items that are or may be re-classified subsequently to profit/(Loss)

Net Fair Value Gain /(Loss) on Available for Sale Securities

Items that will not be re-classified subsequently to profit/(Loss)

Gain on Revaluation of Property, Plant & Equipment

Post-Employment Benefit Plan cost recognized in Other Comprehensive Income

Total Comprehensive Income

	2017 Rs. 000	2016 Rs. 000
Net Profit for the Year	48,356,367	22,179,519
Net Fair Value Gain /(Loss) on Available for Sale Securities	(6,843,970)	2,022,241
Gain on Revaluation of Property, Plant & Equipment	-	3,036,305
Post-Employment Benefit Plan cost recognized in Other Comprehensive Income	1,741,622	9,485,849
Total Comprehensive Income	43,254,019	36,723,914

Figures in brackets indicate deductions

The accounting policies and notes on pages 11 through 60 form an integral part of the Financial Statements.

Central Bank of Sri Lanka

Statement of Changes In Equity

For the year ended 31 December

	Contributed Capital Rs.000	Revaluation Reserve Rs.000	Other Reserves (Note 31) Rs.000	Retained Earnings Rs.000	Total Rs.000
As at 1 January 2016	50,000,000	5,986,602	39,714,048	(41,605,668)	54,094,982
Net Profit for the year	-	-	-	22,179,519	22,179,519
Transfer to RTGS Sinking Fund	-	-	220,272	(220,272)	-
Post Employment Benefit Plan cost recognized in Other Comprehensive Income	-	-	-	9,485,849	9,485,849
Transfer of Net Foreign Exchange Revaluation Loss (IRR)	-	-	(6,775,246)	6,775,246	-
Transfer to CBSL Specific Reserve	-	-	-	(175,470)	(175,470)
Net Fair Value Gain on Available for Sale Securities	-	-	2,022,241	-	2,022,241
Transfer of interim Profit to Government -2016	-	-	-	(5,000,000)	(5,000,000)
Gain on Revaluation of Property, Plant and Equipment	-	3,036,305	-	-	3,036,305
Transfer of Funds to CBSL Employees and Pensioners Distress Relief Fund	-	-	-	(225)	(225)
Transfer of Funds from Market Revaluation Reserve to Retained Earnings	-	-	(4,650,806)	4,650,806	-
As at 31 December 2016	50,000,000	9,022,907	30,530,509	(3,910,215)	85,643,201
As at 1 January 2017	50,000,000	9,022,907	30,530,509	(3,910,215)	85,643,201
Net Profit for the year	-	-	-	48,356,367	48,356,367
Transfer to RTGS Sinking Fund	-	-	273,918	(273,918)	-
Post Employment Benefit Plan cost recognized in Other Comprehensive Income	-	-	-	1,741,622	1,741,622
Transfer of Net Foreign Exchange Revaluation Loss (IRR)	-	-	(3,808,147)	3,808,147	-
Transfer to CBSL Specific Reserve	-	-	-	(166,388)	(166,388)
Net Fair Value Loss on Available for Sale Securities	-	-	(6,843,970)	-	(6,843,970)
Transfer of Funds from Retained Earnings to Market Revaluation Reserve	-	-	14,028,792	(14,028,792)	-
Transfer to General Reserve	-	-	7,462,613	(7,462,613)	-
Profit appropriation for the year 2016 - Recovery of outstanding GOSL obligations from 2016 profit	-	-	-	(1,378,272)	(1,378,272)
Transfer of Funds to CBSL Employees and Pensioners Distress Relief Fund	-	-	-	(321)	(321)
Transfer to Reserve for funding purposes of Post-Employment Benefit	-	-	689,025	(689,025)	-
As at 31 December 2017	50,000,000	9,022,907	42,332,740	25,996,592	127,352,239

Figures in brackets indicate deductions

The accounting policies and notes on pages 11 through 60 form an integral part of the Financial Statements.

Central Bank of Sri Lanka			
Statement of Cash Flows			
For the year ended 31 December			
	Note	2017	2016
		Rs. 000	Rs. 000
Cash Flows from Operating Activities			
Receipts:			
Interest Received - Foreign Currency		24,380,250	11,097,325
Interest Received - Local Currency - Others		843,143	690,326
Liquidity Management and Trading Income		2,772,208	1,755,321
Realised Exchange Loss		(14,514,115)	(19,001,328)
Other Income Received		1,607,790	1,500,669
		15,089,276	(3,957,687)
Disbursements:			
Interest Paid - Foreign Currency		2,740,357	3,922,805
Interest Paid - Local Currency		2,679,274	2,196,385
Payments to Employees		5,245,612	5,464,654
Payments to Suppliers		4,823,628	5,557,729
Tax Paid		902,864	2,595,700
		16,391,735	19,737,273
Net Cash Flows used in Operating Activities	40	(1,302,459)	(23,694,960)
Cash Flows from Investing Activities			
Receipts:			
Net (Increase) /Decrease in Other Local Currency Financial Assets		(1,524,155)	(2,100,302)
Principal Recoveries from Loans and Advances to Other Institutions		487,927	890,497
Proceeds on disposal of Property, Plant and Equipment		3,088	709
Net Increase / (Decrease) in Securities Purchased under Agreement to Re-sell		(29,394,318)	(35,429,276)
		(30,427,458)	(36,638,372)
Disbursements:			
Net Increase / (Decrease) in Foreign Currency Securities		211,673,611	(7,066,141)
Net Increase / (Decrease) in Other Foreign Currency Financial Assets		355,012	30,222,682
Net Increase / (Decrease) in Other Foreign Currency Financial Liabilities		60,818,636	89,038,712
Net Increase / (Decrease) in Other Local Deposits and Payables		(155)	(791)
Purchase of Property, Plant and Equipment net of Grants		265,725	488,036
Purchase of Intangible Assets		7,432	1,124
Purchase of Leasehold Assets		-	5,135
Loans and Advances granted to other Institutions		369,684	488,183
		273,489,945	113,176,940
Net Cash Flows used in Investing Activities		(303,917,403)	(149,815,312)
Cash Flows from Financing Activities			
Receipts :			
Issue of Circulating Currency		628,828,164	595,035,881
Withdrawal of Circulating Currency		(583,552,128)	(533,957,965)
Net Issue of Circulating Currency		45,276,036	61,077,916
Disbursements:			
Net Issues / (Withdrawals) of Circulating Currency on Government Transactions	41	(220,649,290)	160,378,295
Net Issues / (Withdrawals) of Circulating Currency on Transactions with Banks and Financial Institutions	42	(38,460,908)	(121,524,559)
Net Issues / (Withdrawals) of Circulating Currency		(259,110,198)	38,853,736
Net Increase/(Decrease) in Circulating Currency		304,386,234	22,224,180
Disbursements:			
Repayment of Foreign Currency Term Liabilities		(28,666,576)	(13,612,965)
Payments to Other Funds		321	225
Payments to Pension Fund		261,625	-
Transfer of Profits to Consolidated Fund		-	5,000,000
		(28,404,630)	(8,612,740)
Net Cash Flows from Financing Activities		332,790,864	30,836,920
Net Increase/(Decrease) in Cash and Cash Equivalents		27,571,002	(142,673,352)
Exchange Rate Effect on Cash and Cash Equivalents		8,472,902	8,982,404
Cash and Cash Equivalents at the Beginning of the Year		423,783,737	557,474,685
Cash and Cash Equivalents at 31 December	43	459,827,641	423,783,737

Figures in brackets indicate deductions

The accounting policies and notes on pages 11 through 60 form an integral part of the Financial Statements.

Central Bank of Sri Lanka Notes to the Financial Statements

For the year ended 31 December 2017

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. The Bank 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 20th March 2018.

2. SIGNIFICANT ACCOUNTING POLICIES

2.1 Basis of Preparation

The financial statements are prepared on the historical cost basis, except for, gold 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 and liabilities are presented broadly in order of liquidity within such distinguished categories. The Bank considers that this reporting approach provides 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 Bank for the year ended 31 December 2017 have been prepared in accordance with International Financial Reporting Standards (IFRS). Such financial statements are audited by the Auditor General and gazetted as required by the law. However, the amounts in gazetted financial statements would be different from these financial statements due to certain classification differences.

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 Judgements 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.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to estimates are recognized prospectively.

Information about judgements made in applying accounting policies that have the most significant effects on the amounts recognized in the financial statements are described in the following notes

2.2.1 Impairment of Loans and Receivables

The Bank reviews its individually significant loans and advances at each Reporting date to assess whether an impairment loss should be recorded in the Income Statement. The Bank's impairment methodology for assets carried at amortised cost results in the recording of provisions for:

- Specific impairment losses on individually significant exposures;
- Collective impairment of individually not significant exposures.

All categories include an element of management's judgement, in particular for the estimation of the amount and timing of future cash flows and collateral values when determining impairment losses. These estimates are driven by a number of factors, the changing of which can result in different levels of allowances.

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, 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 in the actuarial valuation are disclosed in note 29 to the Financial Statements.

2.2.3 Fair Value of Financial Instruments

Where the fair values of financial assets and financial liabilities recorded on the statement of financial position cannot be derived from active markets,

they are determined using a variety of valuation techniques that include the use of mathematical models. The inputs to these models are derived from observable market data where possible, but if this is not available, judgment is required to establish fair values. The judgments include considerations of liquidity and model inputs such as volatility for longer-dated derivatives.

2.3 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 reporting date. All differences are taken to the Statement of Income. For the purposes of retranslation as at the reporting date the following Sri Lanka Rupee exchange rates for major currencies were used:

Currency	2017 Rs.	2016 Rs.
1 Australian Dollar	119.3796	108.2380
1 Canadian Dollar	121.8598	111.0617
1 Euro	183.1353	158.4959
1 Japanese Yen	1.3580	1.2818
1 Special Drawing Rights (SDR)	217.1608	201.3811
1 Sterling Pound	206.5221	184.5087
1 United States Dollar	152.8548	149.8000
1 Chinese Yuan (Offshore)	23.4847	21.4901

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.

2.4 Fair Value Measurement

The Bank measures financial instruments, such as, foreign securities, derivatives, and non-financial assets such as Gold, at fair value at each reporting date. Also, fair values of financial instruments measured at amortised cost are disclosed in Note 47.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

- In the principal market for the asset or liability, or
- In the absence of a principal market, in the most advantageous market for the asset or liability

The principal or the most advantageous market must be accessible by the Bank.

The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest. A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The Bank uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorised within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

- Level 1 — Quoted (unadjusted) market prices in active markets for identical assets or liabilities
- Level 2 — Valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable.
- Level 3 — Valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable.

For assets and liabilities that are recognised in the financial statements on a recurring basis, the Bank determines whether transfers have occurred between Levels in the hierarchy by re-assessing categorisation (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

2.5 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.

a. Financial Asset

The Bank classifies financial assets in one of the following categories:

- loans and receivables;
- held-to-maturity;
- available-for-sale; or
- at fair value through profit or loss and within the category as:
 - held-for-trading; or
 - designated at fair value through profit or loss.

b. Financial Liabilities

The Bank initially recognises all financial liabilities on the date that they are originated and classifies its financial liabilities as measured at amortised cost or fair value through profit or loss or designated at fair value through profit or loss.

All financial assets and liabilities 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 and liabilities 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.

2.5.1 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”. Upon initial recognition, attributable transaction cost are recognized in profit or loss as incurred. 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 Statement of Income.

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), it is reported as “Gain / (Loss) from realised Price Revaluations”.

2.5.2 Available for Sale Investments

Available for sale investments are non-derivative investments that are designated as available for sale or are not classified as another category of financial assets. Available for sale investments comprise equity securities and debt securities.

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 Statement of Income.

Interest income is recognised in profit or loss using the effective interest method.

2.5.2.1 Equity Investments in financial and other institutions classified as Available for Sale

Unquoted equity securities whose fair value cannot be measured reliably are carried at cost. All other available for sale investments are measured at fair value after initial recognition.

2.5.3 Loans and Receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and that the Bank does not intend to sell immediately or in the near term.

Loans and receivables are initially measured at fair value plus incremental direct transaction costs, and subsequently measured at their amortised cost using the effective interest method.

2.5.4 Held to Maturity

Held-to-maturity investments are non-derivative assets with fixed or determinable payments and fixed maturity that the Bank has the positive intent and ability to hold to maturity, and which were not designated as fair value through profit or loss or as available-for-sale. Held-to-maturity investments are carried at amortised cost using the effective interest method.

2.5.5 Derivative Instruments

The Bank uses derivatives such as cross currency swaps, forward foreign exchange contracts, interest rate swaps, 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’.

When the transaction price differs from the fair value of other observable current market transactions in the same instrument, or based on a valuation technique whose variables include only data from observable markets, the bank immediately recognises the difference between the transaction price and fair value (a Day 1 difference) in ‘Gain / (Loss) from Unrealised Price Revaluations’. In cases where fair value is determined using data which

is not observable, the difference between the transaction price and model value is only recognised in the Statement of Income when inputs become observable, or when the instrument is derecognised.

2.5.6 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. All the IMF related assets and liabilities are recognized at amortised cost using the effective interest method. Exchange gains and losses arising on revaluation of IMF assets and liabilities at the exchange rate applying at reporting date as published by the IMF are recognised in the Statement of Income.

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

2.5.7 Cash and Cash Equivalents

Cash and cash equivalents comprise cash at foreign banks and financial institutions, short-term deposits and highly liquid financial assets with original maturities of less than three months, which are subject to insignificant risk of changes in their fair value, and are used by the Bank in the management of its short-term commitments.

Cash and cash equivalents are carried at amortised cost in the Statement of Financial Position.

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 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 41 and Note 42 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 practices 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.

2.5.8 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 recognised 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 Statement of Income.

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.

2.5.9 Standing Deposit and Lending Facilities

With effect from 01 February 2014, Standing Deposit Facility (former Standing Repurchase (Repo) Facility) was converted in to a 'clean deposit' with no allocation of collateral. Hence, participating institutions invest their excess funds in the Standing Deposit Facility as a clean deposit on a daily basis at standing deposit facility rate.

The procedures of Standing Lending Facility (Formerly Standing Reverse Repurchase (Reverse Repo) Facility) are identical to the Standing Reverse Repurchase Facility.

2.5.10 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 Statement of Income.

2.5.11 Sri Lanka Government Securities

Sri Lanka Government Securities consists of Treasury bills purchased from GOSL. The portfolio is recorded in the Statement of Financial Position at amortised cost.

2.5.12 Provisional 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. These advances are subsequently measured at amortized cost.

2.5.13 Loans to Other Institutions

Loans granted to Other Institutions are recognised and carried at amortized cost 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.

2.5.14 Securities Borrowing 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.

2.5.15 Staff Loans

Bank employees are entitled to loan facilities under concessionary interest rates. These loans which were granted from 2008 onwards 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 date of staff loan granted is considered as 1 January.
- There were no amendments or early settlements.

2.5.16 Impairment of Financial Assets

The Bank assesses at each reporting date whether a financial asset is impaired.

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 Statement of Income.

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 Statement of Income, to the extent that the carrying value of the asset does not exceed its amortized cost at the reversal date.

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 Statement of Income. 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.

2.5.17 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 in the Statement of Income.

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.

2.5.18 Other Financial Assets and Liabilities

Local and foreign currency cash, deposits and short-term advances are recognised on trade date and measured at amortised cost

2.6 Other Assets and Liabilities

2.6.1 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. Section 67(2), Monetary Board is required to endeavor to hold at least a nuclear reserve in gold or currencies freely convertible by the Central Bank, whether directly or indirectly, in to gold as per the MLA. Hence, CBSL holds Allocated – Rs. 126.58 Bn and Un-Allocated – Rs. 15.28 Bn in gold as part of its International Reserves as at 31 December 2017. 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 Statement of Income. Prior to appropriation of profits, the unrealised gains from gold are transferred to the relevant reserve account.

2.6.2 Inventories

2.6.2.1 Currency Inventory

Inventories of the Bank include new currencies that are not yet issued to the circulation. Cost related to production and design of new currency notes and coins are initially recognized at cost. Cost of new currency notes and coins which are issued to the circulation is determined on a weighted average basis and at the time of issue it is charged to Statement of Income. Allowance is made for slow moving inventories.

2.6.2.2 Other Inventories

Other inventories are carried at lower of cost or net realisable value. Cost is determined on a weighted average basis.

2.6.3 Property, Plant and Equipment

Property, Plant and Equipment excluding land & building are stated at cost, 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 revalued amount, being their fair value at the date of revaluation, less any subsequent accumulated depreciation and subsequent accumulated impairment losses.

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

Class of Asset	Useful Life
Buildings on Freehold Land	Over 50 Years
Buildings on Leasehold land	Lower of 50 years or over the lease hold period.
Plant & Plant Integrals	20 Years
Furniture & Equipment	10 Years
Motor Vehicles	5 Years
Motor Vehicles acquired 2014 onwards	10 Years
Computer Hardware	4 Years
Others	3 Years

The carrying values of Property, Plant and Equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable.

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 Statement of Income, in which case the increase is recognized in Statement of Income. A revaluation deficit is recognized in Statement of Income, 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 Statement of Income in the year the asset is de-recognized. The assets' residual values, useful lives and methods are reviewed, and adjusted if appropriate, regularly.

Capital work-in-progress is stated at cost. These are expenses of a capital nature directly incurred in the construction of buildings, major plant and machinery and system development, awaiting capitalisation.

2.6.4 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 and accumulated impairment.

Subsequent expenditure on software assets is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

Amortisation is recognised in income statement on a straight-line basis over the useful life of 4 years, from the date that it is available for use since this most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset.

2.6.5 Other Assets

Other assets are carried at expected realisable values.

2.6.6 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. Impairment losses are recognized in income statement.

2.6.7 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.

2.6.8 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.

2.6.9 Pension and Other Post Employment Benefit Plans

Pension and other Post Employment Benefit Plans operated by the bank are disclosed in Note 29.

2.6.10 Defined Benefit Plans

A defined benefit plan is a post employment benefit plan other than a defined contribution plan. 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. The Bank's obligation in respect of defined benefit plan is calculated separately for each plan by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods; that benefit is discounted to determine its present value. Any unrecognised past service costs and the fair value of any plan assets are deducted. The discount rate is the yield at the valuation date on Government Bonds that have maturity dates approximating to the average remaining years of service. All principal actuarial assumptions disclosed in Note 29 are revised only when a full actuarial valuation is performed.

2.6.11 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.

Obligations for contributions to defined contribution plans are recognized as expense in the Statement of Income as and when they arise.

2.6.12 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 Statement of Income 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 Statement of Income over the expected useful life of the relevant asset on a systematic basis consistent with the depreciation policy of the related asset.

2.6.13 Contingent Liabilities and Commitments

Contingent liabilities are possible obligations whose existence will be confirmed only by uncertain future events or present obligations where the transfer of

economic benefit is not probable or cannot be reliably measured. All guarantees of indebtedness, forward foreign exchange transactions and other commitments, which are not recognized in Statement of Financial Position, are shown under respective headings disclosed as Contingent Liabilities and Commitment items. Where applicable, such amounts are measured at best estimates.

2.7 Income Statement

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 Statement of Income 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:

2.7.1 Interest Income and Expenses

Interest income and expense are recognised in the Statement of Income 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.

2.7.2 Dividends

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

2.7.3 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 Statement of Income, 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.

2.7.4 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.

2.7.5 Operating Leases

All the lease rentals on the operating leases are recognised in the Statement of Income on a straight line basis over the term of the lease

2.7.6 Taxation

The income of the bank is exempted from tax under section 118 of the Monetary Law Act No. 58 of 1949 as amended. Further Bank is exempted from ESC as per the Economic Service Charge (Amendment) Act, No 6 of 2013 and exempted from Value Added Tax on supply of financial services as per Value Added Tax (Amendment) Act No.17 of 2013.

3. STANDARDS ISSUED BUT NOT YET EFFECTIVE

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

3.1 IFRS 9 "Financial Instruments"

IFRS 9, issued in July 2014, is effective for annual periods beginning on or after 1 January 2018, with early adoption permitted. It replaces IAS 39 "Financial Instruments: Recognition and Measurement".

The Bank has completed the initial assessment of the potential impact on its financial statements for the year ended 31st December 2016 resulting from the application of IFRS 9 with the assistance of an external consultant. Based on assessments undertaken to date, the total estimated adjustment of the adoption of IFRS 9 based on balances as at 31st December 2016 are as follows,

- a reduction of approximately 1.5% - 3% of the net profit, related to impairment requirements.
- an increment of approximately 5% - 8% of net assets, related to classification and measurement requirements, other than impairment.

The above assessment is preliminary because not all transition work has been finalised. The actual impact of adopting IFRS 9 as at 1st January 2018 may change because;

- IFRS 9 will require the Bank to revise the accounting process and internal controls and these changes are not yet fully complete, and

- The new accounting policies, assumptions, judgements and estimation techniques employed are subject to change until the Bank finalises its first financial statements for the year ending 31st December 2018 that include the date of initial application.

Classification of Financial Assets

IFRS 9 contains a new classification and measurement approach for financial assets that reflects the business model in which assets are managed and their cash flow characteristics.

IFRS 9 includes three principal classification categories for financial assets: measured at amortized cost, Fair value through other comprehensive income (FVOCI) and Fair value through profit or loss (FVTPL). It eliminates the existing IAS 39 categories of held for trading, held to maturity, loans and receivables and available for sale.

Amortized cost

A financial asset is measured at amortized cost if it meets both of the following conditions and is not designated as FVTPL:

- it is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest (SPPI) on the principal amount outstanding.

Fair Value through Other Comprehensive Income

A financial asset is measured at FVOCI only if it meets both of the following conditions and is not designated as FVTPL

- it is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets
- its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

On initial recognition of an equity investment that is not held for trading, the Bank may irrevocably elect to present subsequent changes in fair value in OCI. This election is made on an investment-by-investment basis.

All financial assets not classified as measured at amortized cost or FVOCI as described above are measured at FVTPL.

Under IFRS 9, derivatives embedded in contracts where the host is a financial asset in the scope of IFRS 9 are not separated. Instead, the hybrid financial instrument as a whole is assessed for classification.

Impact Assessment-Classification

The standard will affect the classification and measurement of financial assets held as at 1 January 2018 as follows,

- Trading assets and derivative assets held for risk management, which are classified as held-for-trading and measured at FVTPL under IAS 39, will also be measured at FVTPL under IFRS 9,
- Loans and advances to banks and to customers that are classified as loans and receivables and measured at amortized cost under IAS 39 will in general also be measured at amortized cost under IFRS 9,
- Held-to-maturity investment securities measured at amortized cost under IAS 39 will in general also be measured at amortized cost under IFRS 9,
- Debt investment securities that are classified as available-for-sale under IAS 39 may, under IFRS 9, be measured at amortized cost, FVOCI or FVTPL, depending on the particular circumstances
- The majority of the equity investment securities that are classified as available-for-sale under IAS 39 will be measured at FVTPL under IFRS 9. However, some of these equity investment securities are held for long-term strategic purposes and will be designated as at FVOCI on 1 January 2018.

Impairment – Financial assets, Loan commitments and financial guarantee contracts

IFRS 9 replaces the 'incurred loss' model in IAS 39 with a forward-looking 'expected credit loss' model. This will require considerable judgment over how changes in economic factors affect Expected Credit Losses (ECLs) which will be determined on a probability-weighted basis.

The new impairment model applies to the following financial instruments that are not measured at FVTPL:

- Financial assets that are debt instruments
- loan commitments and financial guarantee contracts issued (previously, impairment was measured under IAS 37 "Provisions, Contingent Liabilities and Contingent Assets")

Under IFRS 9, no impairment loss is recognized on equity investments

IFRS 9 requires a loss allowance to be recognized at an amount equal to either 12-month ECLs or lifetime ECLs. Lifetime ECLs are the ECLs that result from all possible default events over the expected life of a financial instrument, whereas 12-month ECLs are the portion of ECLs that result from default events that are possible within the 12 months after the reporting date.

Definition of default

CBSL has assessed the definition of default by considering the IFRS 9 definition of "credit impaired" which includes:

- Significant financial difficulty of the issuer or the borrower;
- A breach of contract, such as a default or a past due event;

- The lender(s) of the borrower, for economic or contractual reasons relating to the borrower's financial difficulty, having granted to the borrower a concession(s) that the lender(s) would not otherwise consider;
- It is becoming probable that the borrower will enter bankruptcy or other financial reorganization;
- The disappearance of an active market for the financial asset because of financial difficulties; or
- The purchase or origination of a financial asset at a deep discount that reflects the incurred credit losses.

The definition of default that CBSL adopts is largely similar to the definition of default used by Independent Rating Agencies such as Moody's, S&P and Bloomberg.

Significant increase in credit risk

Under IFRS 9, when determining whether the credit risk (i.e. risk of default) on a financial instrument has increased significantly since initial recognition, the Bank will consider downgrading of external credit rating below the investment grade or based on the concept of rating downgrade leading to doubling Probability of Default.

The key inputs into the measurement of ECLs are likely to be the term structures of the following variables

- Probability of Default (PD)
- Loss given default (LGD)
- Exposure at default (EAD)

These parameters will be derived from internally developed statistical models and other historical data that leverage regulatory models. They will be adjusted to reflect forward-looking information as described below.

Probability of Default (PD)

PD estimates are estimates at a certain date, which will be extracted and calculated using market data and statistical models tailored to the various categories of counterparties and exposures.

Loss given default (LGD)

LGD is the magnitude of the likely loss if there is a default. The LGD models will consider the structure, collateral, seniority of the claim, counterparty industry and recovery costs of any collateral that is integral to the financial asset.

Exposure at default (EAD)

EAD represents the expected exposure in the event of a default. The Bank will derive the EAD from the current exposure to the counterparty and potential changes to the current amount allowed under the contract, including amortization, and prepayments. The EAD of a financial asset will be the gross carrying amount at default.

Forward-looking information

Under IFRS 9, the Bank will incorporate forward-looking information into both its assessment of whether the credit risk of an instrument has increased significantly since

initial recognition and its measurement of ECLs. The Bank will formulate a 'base case' view of the future direction of relevant economic variables and a representative range of other possible forecast scenarios by considering a variety of external actual and forecast information.

Classification – Financial Liabilities

IFRS 9 largely retains the existing requirements in IAS 39 for the classification of financial liabilities. However, under IAS 39 all fair value changes of financial liabilities designated as FVTPL are recognized in profit or loss, whereas under IFRS 9 these fair value changes will generally be presented as follows,

- the amount of the change in the fair value that is attributable to changes in the credit risk of the liability will be presented in OCI; and
- the remaining amount of the change in the fair value will be presented in profit or loss

Transition

Changes in accounting policies resulting from the adoption of IFRS 9 will generally be applied retrospectively.

3.2 IFRS 16 "Leases"

The IASB issued the new standard for accounting for leases - IFRS 16 Leases in January 2016. The new standard does not significantly change the accounting for leases for lessors. However, it does require lessees to recognise most leases on their balance sheets as lease liabilities, with the corresponding right-of-use assets. Lessees must apply a single model for all recognised leases, but will have the option not to recognise 'short-term' leases and leases of 'low-value' assets. Generally, the profit or loss recognition pattern for recognised leases will be similar to today's finance lease accounting, with interest and depreciation expense recognised separately in the statement of income.

IFRS 16 is effective for annual periods beginning on or after 1 January 2019. Early application is permitted provided the new revenue standard, IFRS 15, is applied on the same date. Lessees must adopt IFRS 16 using either a full retrospective or a modified retrospective approach.

The Bank does not anticipate early adopting IFRS 16 and is currently evaluating its impact.

3.3 IFRS 15 "Revenue from Contracts with Customers"

In May 2014, the IASB issued IFRS 15 Revenue from Contracts with Customers, effective for periods beginning on 1 January 2018 with early adoption permitted. IFRS 15 defines principles for recognizing revenue and will be applicable to all contracts with customers. However, interest and fee income integral to financial instruments and leases will continue to fall outside the scope of IFRS 15 and will be regulated by the other applicable standards (e.g., IFRS 9 Financial Instruments and IFRS 16 Leases).

Revenue under IFRS 15 will need to be recognised as goods and services are transferred, to the extent that the transferor anticipates entitlement to goods and services. The standard will also specify a comprehensive set of disclosure requirements regarding the nature, extent and timing as well as any uncertainty of revenue and corresponding cash flows with customers.

The Bank does not anticipate early adopting IFRS 15 and is currently evaluating its impact.

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 as amended, vested with the powers, duties and functions of the CBSL and are 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 payment 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 Statement of Income.

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, Japanese Yen

and New Zealand Dollars. 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. CASH AND CASH EQUIVALENTS

	2017 Rs. 000	2016 Rs. 000
Cash Balances with Banks	16,518,603	68,594,961
Time Deposits with Banks	269,193,626	281,094,724
Overnight Placements	173,979,333	74,031,160
Interest Receivable on Cash and Cash Equivalents	136,079	62,892
Total	459,827,641	423,783,737

6. INVESTMENT IN FOREIGN SECURITIES

	2017 Rs. 000	2016 Rs. 000
Securities at Fair Value through Profit or Loss		
-Investment in Foreign Securities	29,988,753	29,882,588
-Gold (Un-Allocated)	15,275,623	13,396,167
	45,264,376	43,278,755
Available for Sale Investments		
-Investment in Foreign Securities	566,228,935	341,225,162
-Unit Investment	-	7,319,488
	566,228,935	348,544,650
Total Investment in Foreign Securities	611,493,311	391,823,405

Investment in foreign securities classified as securities at fair value through profit or loss includes the investments made by CBSL during 2016 in the Reserve Advisory Management Program (RAMP) managed by the World Bank. The value of the investment with RAMP as at 31st December 2017 was Rs. 29,988.75 Mn.

7. DERIVATIVE FINANCIAL INSTRUMENTS

7.1 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 period end and are indicative of neither the market risk nor the credit risk.

	2017			2016		
	Assets Rs. 000	Liabilities Rs. 000	Notional Amount Rs. 000	Assets Rs. 000	Liabilities Rs. 000	Notional Amount Rs. 000
Currency SWAPS	4,939,919	3,403,868	228,553,847	198,880	8,659,453	374,297,030
Forward Forex	536	-	132,773	-	2,410	2,771,960
Embedded Derivatives - Currency Options	-	1,244,581	13,374,795	-	5,911,812	85,524,565
Total	4,940,455	4,648,449	242,061,415	198,880	14,573,675	462,593,555

7.2 The above derivatives consisting of Currency Swaps, Currency Options and Foreign Exchange Forward Contracts were used for the purpose of managing market and liquidity risks in international reserves held by the Bank in line with the statutory objectives of maintenance of international reserves. In addition, the Bank entered into Swap transactions with Licensed Commercial Banks (LCBs), Licensed Specialized Banks (LSBs) and Foreign Central Banks in order to maintain international stability of the Sri Lankan Rupee, to strengthen the financial system of the country and to encourage those Banks to bring foreign funds.

7.3 Derivatives are financial contracts that derive their value in response to changes in interest rates, financial instruments prices, commodity prices, foreign exchange rates, credit risk and indices.

7.4 A significant part of derivatives portfolio of the Bank consists of currency swaps entered into as a strategy to manage the short term liquidity requirements. In a currency swap, the Bank pays/receives a specified amount of a currency on an agreed date in exchange of another currency at agreed rates.

7.5 From Foreign Exchange Forward contracts, the Bank gets the obligation to buy or sell specific amount

of foreign currency on an agreed future date at an agreed rate.

7.6 The Bank's exposure to derivative contracts is closely monitored as part of the overall risk management of the Bank to ensure expected benefits from such derivatives are crystalized to the Bank.

8. IMF RELATED ASSETS

	2017 Rs. 000	2016 Rs. 000
Holding of Special Drawing Rights	677,131	303,070
IMF Quota	125,996,456	116,559,364
Deposits with IMF	164,565	145,906
Total IMF Related Assets	126,838,152	117,008,340

8.1 Holding of Special Drawing Rights

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 these currencies. The SDRs value as a reserve asset derives from the commitments of members to hold and accept SDRs, and to honor various obligations connected with the operation of the SDR system. The IMF ensures that the SDRs claim on freely usable currencies is being honored 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 reporting dates.

8.2 IMF Quota

The IMF Quotas (capital subscriptions) are the primary source of IMF resources received from its member countries. Each country's quota is determined broadly on the basis of the relative economic size of the country. Upon joining the IMF, a country must pay 25 per cent of its quota in widely accepted foreign currencies or SDRs, and the remaining 75 per cent in its own currency. The IMF quota represents an asset of the Bank as it transacts with the IMF on its own account on behalf of the Government as per Articles of the IMF.

The IMF, based on the General Quota Review Agreement, decided to increase the quotas of each of the IMF's 189 members in January 2016. As a result, Sri Lanka's IMF quota increased to SDR 578.80 Mn on 17 February 2016 from the previous quota amount of SDR 413.40 Mn.

The amounts payable in respect of the IMF Quota is shown under the heading Quota Liability in Note 20. A member's quota determines that country's financial and organizational relationship with IMF, including:

- (i) **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 per cent must be paid in reserve assets specified by the IMF (SDRs or usable currencies), and the rest in the member's own currency.
- (ii) **Voting power:** The quota defines a member's voting power in IMF decisions. IMF member's votes are comprised of basic votes plus one additional vote for each SDR 100,000 of quota. The 2008 reform fixed the number of basic vote at 5.50 per cent of total votes.
- (iii) **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 145 per cent of its quota annually and 435 per cent cumulatively. Access may be higher in exceptional circumstances.
- (iv) **SDR allocations:** Members' shares of SDR allocations are established in proportion to their quotas.

8.3 Deposits with IMF – PRGF – HIPC Trust Deposit

The PRGF – HIPC (Poverty Reduction and 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. The 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.

9. SRI LANKA GOVERNMENT SECURITIES

Portfolio of government securities is acquired and maintained as per Section 90 (2) of the Monetary Law Act for the purpose of open market operations to be carried out in the conduct of the monetary policy.

	2017 Rs. 000	2016 Rs. 000
Treasury Bills	9,704,962	320,605,082
Securities held under Reverse Repurchase Agreements	22,359,000	30,807,000
Interest Receivable on Reverse Repurchase Agreements	16,124	14,388
	<u>32,080,086</u>	<u>351,426,470</u>

10. PROVISIONAL ADVANCES TO GOVERNMENT

These represent advances granted to the Government of Sri Lanka (GOSL) under Section 89 of the Monetary Law Act subject to the conditions stated in provision of advances to finance expenditures authorised to be incurred out of the Consolidated Fund.

11. LOANS TO BANKS

These are the loans granted in terms of Part IIIA of Chapter V of the Monetary Law Act to facilitate lending for productive purposes.

	2017 Rs. 000	2016 Rs. 000
Medium & Long Term Credit Scheme (MLTC)		
- Related Parties	29,146	31,340
Provincial Development Credit Loan Scheme		
- Related Parties	28,254	112,652
Saubaghya Loan Scheme		
- Related Parties	49,539	101,176
- Others	14,211	30,768
Resumption of Economic Activities in the East		
- Related Parties	41,382	115,977
- Others	35,492	53,296
Repair of Damaged Houses North & East		
- Related Parties	24,330	30,310
Awakening North Loan Scheme (RF Phase II)		
- Related Parties	1,348	34,632
- Others	-	1,194
Less:		
Impairment (Note 11.1)	-	(27,302)
Net Receivable	<u>223,702</u>	<u>484,043</u>

11.1 Movement in Provision for Impairment

	2017 Rs. 000	2016 Rs. 000
As at 1st January	27,302	27,302
Impairment/Reversal during the year	(27,302)	-
As at 31 December	<u>-</u>	<u>27,302</u>

12. EQUITY INVESTMENTS IN FINANCIAL AND OTHER INSTITUTIONS

These investments are made in terms of Section 105 A of the Monetary Law Act. Under this Section, the Bank is empowered 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.

(i) Investment position

Company	Nature of the Business	% Holding	
		2017	2016
Lanka Clear (Private) Limited	Automated Clearing	19.66	19.66
Fitch Ratings Lanka Limited	Credit Rating	10.00	10.00
Lanka Financial Services Bureau Limited	Automated Fund Transfers	7.50	7.50
Credit Information Bureau of Sri Lanka Limited	Provision of Credit Information	19.30	19.30

(ii) The carrying value of investments

Company	2017 Rs. 000	2016 Rs. 000
Credit Information Bureau of Sri Lanka Limited	5,845	5,845
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
Total Investments	41,095	41,095

13. OTHER ASSETS

	2017 Rs. 000	2016 Rs. 000
Financial Assets		
Investment of Internal Funds	6,443,984	5,208,837
Interest Receivable on Internal Funds	286,564	170,394
Less: Provision for Impairment of Assets	(151,674)	(139,131)
Net Investment of Internal Funds	6,578,874	5,240,100
Staff Loans at Amortized Cost	5,036,028	4,588,285
Receivable from Treasury and Other Ministries	54,490	1,401,497
Investment in Debentures at Amortized Cost (Note 13.1)	-	11,964
Other Receivables	143,276	235,918
	11,812,668	11,477,764
Non Financial Assets		
Deffered asset on Staff Loan	1,069,802	1,015,226
	12,882,470	12,492,990

16. PROPERTY, PLANT AND EQUIPMENT

Cost	Land and Buildings Rs.000	Plant & Plant Integrals Rs.000	Furniture & Equipment Rs.000	Vehicles Rs.000	Computers Rs.000	Others		2017 Total Rs.000	2016 Total Rs.000
						Reading Materials Rs.000	Construction In progress Rs.000		
As at 01 January	16,724,361	1,495,922	1,281,814	489,475	843,039	54,008	31,395	20,920,014	18,603,049
Revaluation gain for the year	-	-	-	-	-	-	-	-	1,848,249
Additions	-	1,637	27,794	125,100	20,034	1,428	91,136	267,129	493,172
Disposals	-	(3,530)	(6,396)	(12)	(19,708)	-	-	(29,646)	(19,321)
Transfers	18,839	73,641	1,845	-	-	-	(94,325)	-	(5,135)
As at 31 December	16,743,200	1,567,670	1,305,057	614,563	843,365	55,436	28,206	21,157,497	20,920,014
Depreciation	Land and Buildings Rs.000	Plant & Plant Integrals Rs.000	Furniture & Equipment Rs.000	Vehicles Rs.000	Computers Rs.000	Others		2017 Total Rs.000	2016 Total Rs.000
As at 01 January	52,341	784,842	787,049	376,456	751,788	35,148	-	2,787,624	3,180,734
Depreciation for the year	199,193	76,782	81,065	33,997	42,496	1,025	-	434,558	434,688
Adjustment due to Revaluation	-	-	-	-	-	-	-	-	(809,150)
Disposals	-	(677)	(5,019)	(12)	(19,494)	-	-	(25,202)	(18,648)
As at 31 December	251,534	860,947	863,095	410,441	774,790	36,173	-	3,196,980	2,787,624
Net Book Value	16,491,666	706,723	441,962	204,122	68,575	19,263	28,206	17,960,517	18,132,390

13.1 Investment in Debentures at Amortized Cost of Rs. 11.96 mn represents the Debentures of Sri Lanka Savings Bank Ltd which matured on 03 December 2017.

14. GOLD

This is the value of physical gold held as required under Section 67 (1) and Section 67(2) of the Monetary Law Act (MLA) as part of the International Reserve of the Bank. As per Section 67(2), Monetary Board is required to endeavor to hold at least a nuclear reserve in gold or currencies freely convertible by the Central Bank, whether directly or indirectly, in to gold as per the MLA.

15. INVENTORIES

	2017 Rs. 000	2016 Rs. 000
Notes for Circulation	4,442,014	3,402,661
Coins for Circulation	1,850,723	1,779,021
Coins in Transit from the Supplier	-	116,197
Notes in Transit from the Supplier	568,716	803,227
	6,861,453	6,101,106
Less: Provision for Slow Moving Items	(45,000)	(45,000)
	6,816,453	6,056,106
Stationery and Sundry Inventory	58,881	58,557
Medical Center Stock	199	198
Total Inventories at Lower of Cost or Net Realizable Value	6,875,533	6,114,861

The carrying values of Land and Buildings are recorded at fair value. The latest independent valuation was performed as at 31 December 2016 by FM Valuers, which was recorded as at 31 December 2016.

The properties of the bank at New York and Brazil have not been recorded at fair value since the Cabinet has approved the transfer of such properties to the Secretary to the Ministry of Foreign Affairs at cost in November 2016. Further, the

properties are disclosed under PPE without classifying as assets held for sale.

During the financial year, the Bank has acquired property, plant and equipment by means of cash with an aggregated cost of Rs. 265.73 Mn (2016 - Rs. 488.04 Mn).

The value of the fully depreciated assets which are still in use as at 31 December 2017 was Rs. 1,598.17 Mn. (2016 - Rs. 1,404.91 Mn).

Information on Valuations of Freehold Land and Buildings and Buildings on Leasehold Land of the Bank

Property	Name of the chartered valuation surveyor	Valuation approach	Estimated price per perch (Rs.)	Estimated price per square foot (Rs.)	Estimated rent per month (Rs.)	Outgoing expenses	Years Purchase
Land & Building							
Head Office - Colombo 01	A. A. M. Fathihu	Market Approach & Cost Approach	12,500,000	9,000 - 15,000	-	-	-
Whiteaways Building - Colombo 01	-do-	Income Approach	13,500,000	-	6,000,000	40%	16.66
Lloyds Building - Colombo 01	-do-	Income Approach	13,500,000	-	6,750,000	40%	16.66
Central Point Building - Colombo 01	-do-	Income Approach	14,000,000	-	7,500,000	35%	16.66
Centre for Banking Studies - Rajagiriya	-do-	Market Approach & Cost Approach	2,500,000 - 3,500,000	2,500 - 9,500	-	-	-
Bank House - Colombo 07	-do-	Market Approach & Cost Approach	7,500,000	3,500 - 8,500	-	-	-
Regional Office - Matara	-do-	Market Approach & Cost Approach	1,500,000 - 3,000,000	4,000 - 7,500	-	-	-
Regional Office - Matale	-do-	Market Approach & Cost Approach	100,000 - 500,000	2,500 - 7,500	-	-	-
Holiday Home - Nuwara Eliya	-do-	Market Approach & Cost Approach	1,000,000	2,000 - 7,000	-	-	-
Holiday Home - Kataragama	-do-	Market Approach & Cost Approach	200,000	4,500 - 10,000	-	-	-
Building on Leasehold Land							
Regional Office - Anuradhapura	A. A. M. Fathihu	Cost Approach	-	3,500 - 7,500	-	-	-
Holiday Home - Anuradhapura	-do-	Cost Approach	-	5,500	-	-	-
Regional Office - Kilinochchi	-do-	Cost Approach	-	1,500 - 7,000	-	-	-
Holiday Home - Somawathiya	-do-	Cost Approach	-	10,000	-	-	-

Composition of Land and Buildings

	Carrying Value 2017 Rs. 000	Carrying Value 2016 Rs. 000
Freehold Land	8,976,339	8,976,339
Buildings on Freehold Land	7,250,954	7,424,981
Buildings on Leasehold Land	264,373	270,700
	<u>16,491,666</u>	<u>16,672,020</u>

The carrying amount of revalued Land and Buildings that would have been included in the financial statements had they been carried at cost less depreciation is Rs. 8,607.88 Mn (2016 - Rs.8,762.63 Mn).

17. INTANGIBLE ASSETS

	2017 Rs. 000	2016 Rs. 000
Computer Software:		
Cost:		
As at 1 January	949,772	948,648
Additions	7,432	1,124
As at 31 December	<u>957,204</u>	<u>949,772</u>
Amortization and Impairment:		
As at 1 January	793,452	708,038
Amortization Charge for the year	83,129	85,414
As at 31 December	<u>876,581</u>	<u>793,452</u>
Net Book Value:		
As at 31 December	<u>80,623</u>	<u>156,320</u>

During the financial year, the Bank has acquired intangible assets with an aggregated cost of Rs. 7.43 Mn (2016 - Rs. 1.12 Mn).

The value of the fully amortized intangible assets which are still in use as at 31 December 2017 was Rs. 636.58 Mn (2016 - Rs. 613.34 Mn).

18. BANKS AND FINANCIAL INSTITUTIONS

	2017 Rs. 000	2016 Rs. 000
Payable to Foreign Banks	8,237,633	45,267,025
Payable to other Foreign Financial Institutions	445,400	299,656
	<u>8,683,033</u>	<u>45,566,681</u>

19. ASIAN CLEARING UNION

The Asian Clearing Union (ACU) was established in 1974 at the initiative of the United Nations Economic and Social Commission for Asia and the Pacific (ESCAP) as a mechanism to settle, on a multilateral basis of payments for intra-regional transactions among participating Central Banks.

The participants of ACU are Sri Lanka, Bangladesh, Iran, Nepal, Pakistan, India, Bhutan, Myanmar and Maldives. Net position as at end of each month is settled or received, after two months credit period. Interest between 0.63 % and 1.28 % in USD (2016 - 0.34 % and 0.51 %) was paid during January to December 2017 by net debtors to net creditors on daily outstanding balances between settlement dates. The balance represents the amounts due to ACU at the respective reporting dates.

20. IMF

	2017 Rs. 000	2016 Rs. 000
Interest Bearing Loans - Non Current	116,996,460	48,288,764
Interest Bearing Loans - Current	-	34,687,890
Allocation of Special Drawing Rights	86,086,013	79,638,200
Other Amounts Payable to IMF	57,137,759	52,858,160
Quota Liability	58,445,100	54,067,582
	201,668,872	221,251,832
Total IMF Related Liabilities	318,665,332	269,540,596

20.1 Interest bearing Loans consist of the Extended Fund Facility (EFF) and Stand By Arrangement (SBA) obtained from the IMF.

20.2 Extended Fund Facility (EFF) is a three year facility provided by the IMF to support the Balance of Payments and Government's economic reform agenda. The IMF approved the EFF of SDR 1.10 Bn (approximately USD 1.50 Bn) in June 2016. This amount is equivalent to 185 per cent of the country's current quota with the IMF. The first tranche under the EFF amounting to SDR 119.89 Mn (approximately USD 168.10 Mn) was made available in June 2016. The second tranche to the value of SDR 119.89 Mn (approximately US dollars 162.56 Mn), third tranche to the value of SDR 119.89 Mn (approximately USD 167.2 Mn) and the fourth tranche to the value of SDR 177.77 Mn (approximately USD 251.4 Mn) were disbursed in November 2016, July 2017 and December 2017, respectively. With the disbursement of the fourth tranche, a total of USD 759.9 Mn has been received thus far by Sri Lanka on account of EFF. The remaining amount is expected to be disbursed in three more tranches over a period of two years, with the final tranche expected in April 2019. The interest rate applicable on the EFF comprise of the basic rate of charge, which is equivalent to the SDR interest rate (currently stands at 0.05 per cent per annum) plus 100 basis points.

20.3 Stand By Arrangement (SBA) is a balance of payment support financing facility provided by the IMF subject to certain conditions on macroeconomic management

of the borrowing countries. The IMF approved a SBA facility of SDR 1.65 Bn (USD 2.60 Bn) for Sri Lanka in July 2009 as a balance of payment support. The SBA was successfully completed in 2012 with the final tranche received in July 2012. This loan facility is repayable within 5 years and the repayments commenced in October 2012. The rate of interest payable is composed of two components; the service charge and a fixed margin. The service charge is calculated weekly, based on the SDR interest rate. The fixed margin is 1 per cent per annum for the outstanding loan amount up to 300 per cent of the quota with the IMF. When the outstanding loan amount exceeds 300 per cent of the quota, a surcharge of 2 per cent per annum will be levied on the outstanding in excess of 300 per cent. The first repayment of SDR 25.80 Mn was made on 25 October 2012.

Total amount of SDR 1,455.52 Mn of repayments were done during the years 2013-2016 and the outstanding balance as at 31st December 2016 was SDR 172.25 Mn which was repaid during the period from January to July 2017. As at 31 December 2017, there is no outstanding balance for SBA facility.

The amounts expected to be settled before and after 12 months in connection with interest bearing loans are as follows:

	Effective interest rate %	Maturity	2017 Rs. 000	2016 Rs. 000
Current SBA	0.244	2017	-	34,687,890
			-	34,687,890
Non-current EFF	0.74	2027	116,996,460	48,288,764
			116,996,460	48,288,764
Total Interest bearing loans			116,996,460	82,976,654

20.4 The Special Drawing Right (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 created SDRs to supplement existing official reserve assets such as gold holdings, foreign exchange and reserve positions in the IMF. 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 8. Members of IMF are 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.

20.5 Other Amounts Payable to IMF represent amounts owed by the Bank to IMF on account of operational and administrative transactions.

20.6 Quota Liability: The amounts payable in respect of the IMF Quota as described in Note 8.2.

21. OTHERS

	2017 Rs. 000	2016 Rs. 000
DST-PRP II under Escrow Agreement (Note 21.1)	0	364,794
Moragahakanda Development Project Loan under Escrow Agreement (Note 21.2)	2,056,009	5,857,173
DST - PRP III under Escrow Agreement (Note 21.3)	7,588,467	13,245,476
DST - PRP III Phase II under Escrow Agreement (Note 21.4)	8,094,403	12,754,696
DST Special Dollar A/C - Small & Medium Enterprises (SME) and Green Energy Global Loan (Note 21.5)	109,808	2,195,121
DST Special Dollar A/C - Ambatale Water Supply Improvement Project (Note 21.6)	189,196	291,768
DST - NORAD Waso Asia Project of the University of Peradeniya (Note 21.7)	10,664	6,409
Amount due to Reserve Bank of India (RBI) under SAARC swap facility (Note 21.8)	-	59,920,000
DST Dollar A/C - Hambantota Port (Note 21.9)	44,648,475	-
Other Foreign Liabilities	1,398,867	1,614,595
	64,095,889	96,250,032

21.1 Priority Road Project II under Escrow Agreement

A Facility Agreement between China Development Bank Corporation (CDB) and Government of Sri Lanka was signed on 31st March 2011 for USD 500 Mn. The funds of this Facility Agreement are used for the improvement and rehabilitation of priority roads. As per the Facility Agreement, the Bank has been appointed as the Escrow Agent. Accordingly, an Escrow Account has been opened in the Bank for the sole purpose of depositing the loans and disbursing such received monies to the Road Project, and this account shall be jointly operated by the lender (CDB) and the borrower (GOSL) pursuant to this Agreement.

The last disbursement under this project was done on 25th July 2017 and remaining balance as at 31 December 2017 is USD 0.09 only.

21.2 Moragahakanda Development Project Loan under Escrow Agreement

This Loan Agreement was signed between China Development Bank (as lender) and the Government of Sri Lanka (as borrower) on 28th June 2012 for USD 214.20 Mn. The purpose of this loan agreement is to provide facility for financing the construction of a hydroelectric power station at Moragahakanda. This Project has been implemented by the Ministry of Irrigation and Water Resources Management. The Bank opened an account in its books of account, as the Banker to this agreement, according to the instructions of the Department of External Resources for the purpose of receiving and disbursing the loan. During the year 2017, USD 25.65 Mn was disbursed and the balance as at 31st December 2017 is USD 13.45 Mn.

21.3 Priority Road Project III under Escrow Agreement

This Facility Agreement was signed between the China Development Bank (as the lender) and the Government of Sri Lanka (as the borrower) on 11th March 2014 for USD 300 Mn. The purpose of this loan is to finance the cost of improvement and rehabilitation of Priority Road Project III-Phase I. As per the Facility Agreement, the Bank has been appointed as the Banker to the Government of Sri Lanka. Accordingly, an account has been opened in its books of account for the sole purpose of depositing the loan and disbursing such received monies to the Road Project. During the year of 2017, USD 38.78 Mn was disbursed and the remaining balance as at 31st December 2017 is USD 49.64 Mn.

21.4 Priority Road Project III Phase II under Escrow Agreement

The Phase II of this agreement was received on 24th November 2014 for USD 100 Mn. During the year 2017, USD 32.19 Mn was disbursed and the remaining balance as at 31st December 2017 is USD 52.96 Mn.

21.5 SME and Green Energy Global Loan

This is a Finance Contract between the Democratic Socialist Republic of Sri Lanka and the European Investment Bank signed on 13th November 2013. As per the Facility Agreement, the Bank has been appointed as the Banker to the Government of Sri Lanka. Accordingly, an account has been opened in its books of account for depositing the loan proceeds and disbursing such received money to the project.

The second tranche of the above SME and Green Energy Global Loan was received in Euro on 09 July

2015. Accordingly, an account has been opened in the books of account of the CBSL for depositing the loan and disbursing such received money to the project.

During the year 2017, USD 13.94 Mn was disbursed and the balance as at 31 December 2017 is USD 0.71 Mn.

21.6 DST Special Dollar Account - Ambatale Water Supply Improvement Project

This Credit Facility Agreement was signed between Agence Francaise de Development as the Lender and the Democratic Socialist Republic of Sri Lanka as the Borrower on 29 September 2014. The Bank has opened an account in its books of account, as the Banker to this agreement, according to the the instructions of the Department of Treasury operations for the purpose of receiving and disbursing the loan. USD 5 Mn was received to the above account on 14 September 2015.

During the year 2017, USD 0.71 Mn was disbursed and the balance as at 31 December 2017 is USD 1.24 Mn.

21.7 NORAD Waso Asia Project of the University of Peradeniya

The Central Bank of Sri Lanka is maintaining USD Account NORAD Waso Asia Project of the University of Peradeniya on behalf of the University of Peradeniya to receive funds from NORAD for the Capacity Building Project since 2016. University of Peradeniya is expecting to withdraw the funds in USD or LKR by submitting the withdrawal applications through Treasury Operations Department. During the year 2017, two receipts totalling to USD 0.07 Mn was received to the account and USD 0.04 Mn was transferred to DST. Balance as at 31st December 2017 is USD 0.07 Mn.

21.8 Amount due to Reserve Bank of India (RBI) under SAARC swap facility

Outstanding balance as at 31 December 2016 represents the drawing of USD 400 Mn and the repayment of this tranche was done on 16 March 2017.

21.9 DST's Dollar A/C - Hambantota Port

This is a special dollar account maintained on behalf of the Treasury Operations Department crediting the proceeds from China Merchant Port Holdings Co. Ltd, received for handing over the operations of Hambantota Port subsequent to the agreement signed between Sri Lanka Ports Authority and the China Merchant Port Holdings

Co. Ltd. Initial proceeds of USD 292.1 Mn was received on 22 December 2017 and the same remained as the balance as at 31 December 2017.

22. DEPOSITS OF BANKS AND FINANCIAL INSTITUTIONS

These are the deposits maintained by LCBs for the purpose of meeting Statutory Reserve Requirement under section 93 of the Monetary Law Act and deposits maintained by LCBs, Primary Dealers in Government Securities and the Employee Provident Fund and as participants of Real Time Gross Settlement System (RTGS) for honoring payments under the RTGS operated by the Bank as per the provisions of the Monetary Law Act. Under the scheme, an interest free intra-day liquidity facility, fully collateralized by Government is available to participants to meet payment obligations within the day to facilitate smooth functioning of the settlement system. Although these deposits are classified as related parties (i.e., State owned Banks and institutions) and others for the purpose of accounting disclosure requirements, such deposits are maintained in terms of relevant statutory provisions and not because of specific business relationship of the Bank with those state institutions.

	2017 Rs. 000	2016 Rs. 000
Deposits by Banks :		
- Related Parties	215,901,806	183,836,224
- Others	125,805,585	110,060,140
	341,707,391	293,896,364
Deposits by Financial Institutions :		
- Related Parties	94	477
- Others	4,713	9,354,449
	4,807	9,354,926
Total Deposits by Banks and Other Financial Institutions	341,712,198	303,251,290

23. DEPOSITS OF GOVERNMENT AND GOVERNMENTAL ENTITIES

	2017 Rs. 000	2016 Rs. 000
Government Deposits	167,492	167,615
Government Agencies and Funds	157,025	283,269
	324,517	450,884

These are the deposits maintained in terms of Section 106(1) of the Monetary Law Act as the Bank is the official depository of the Government and/ or government agencies or institutions.

24. SECURITIES SOLD UNDER REPURCHASE AGREEMENTS

	2017	2016
	Rs. 000	Rs. 000
Government Securities	6,503,884	21,383,724
Standing Deposit Facility (Note 2.5.9)	34,151,394	48,670,712
	<u>40,655,278</u>	<u>70,054,436</u>

Repurchase agreements are undertaken for Open Market Operations (OMO) to regulate liquidity in the money market under Sections 90 and 91 of Monetary Law Act as part of conduct of the monetary policy. These repurchase agreements were engaged only in Government securities on over-night basis or term basis depending on the market liquidity management policies of the Bank, decided from time to time.

25. BALANCES OF EMPLOYEE BENEFIT PLANS

The Bank as a part of normal activities provides current account facilities for its Employee Benefit Plans. The amounts held in credit of these separately administered current accounts and inter entity accounts of Employee Benefit Plans of the Bank, are as follows:

	2017	2016
	Rs. 000	Rs. 000
Balances in CBSL Provident Fund, Pension Schemes and Widows'/Widowers' & Orphans' Pension Schemes	4,547	51,744
	<u>4,547</u>	<u>51,744</u>

26. 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 reporting dates are as follows:

Denomination	2017	2016
Coins:	Rs. 000	Rs. 000
1 cent	3,631	3,631
2 cent	5,707	5,703
5 cent	23,258	23,247
10 cent	39,229	39,208
25 cent	121,039	120,586
50 cent	185,590	185,611
1 rupee	898,148	851,968
2 rupee	1,357,849	1,272,301
5 rupee	4,102,486	3,725,947
10 rupee	5,402,312	4,505,834
Commemorative coins	587,075	584,177
	<u>12,726,324</u>	<u>11,318,213</u>

Notes:

1 rupee	4,981	4,981
2 rupee	26,696	26,696
5 rupee	37,193	37,194
10 rupee	1,340,240	1,382,089
20 rupee	5,758,265	5,331,571
50 rupee	5,561,352	5,141,033
100 rupee	21,599,562	20,590,404
200 rupee	130,040	130,526
500 rupee	38,153,548	33,475,699
1000 rupee	141,832,264	141,169,379
2000 rupee	10,526,029	20,436,195
5000 rupee	360,357,407	313,733,885
	<u>585,327,577</u>	<u>541,459,652</u>
Total Currency in Circulation	<u>598,053,901</u>	<u>552,777,865</u>

27. OTHER PAYABLES

	2017	2016
	Rs. 000	Rs. 000
Domestic Interest Payable	1,676	-
Provision and Charges	396,531	563,783
Deposits by RDD	2,306,897	2,440,187
Liability against Abandoned Properties Received (Note 27.1)	5,083,171	4,094,268
Other Payables	1,098,881	1,465,310
	<u>8,887,156</u>	<u>8,563,548</u>

27.1 Payable in respect of Abandoned Properties represents the amounts collected from the Licensed Commercial Banks under the Banking Act Direction 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 Treasury Bill interest rate is recorded as a liability of the Bank.

28. DEFERRED GRANTS

	2017	2016
	Rs. 000	Rs. 000
As at 01 January	80	106
Amortization during the year	(35)	(26)
As at 31 December	<u>45</u>	<u>80</u>

Deferred grant is amortized over the period that matches with the depreciation policy of such assets. This includes the assets received by the Bank without any consideration. The fair value of the assets have been credited to a deferred grant account and taken to other income over the useful life of the relevant asset consistent with the depreciation policy of the related asset.

29. PENSION AND OTHER POST EMPLOYMENT BENEFIT PLANS

The Bank operates six defined benefit plans which cover all eligible employees. Under the Employees' Retirement Pension Scheme (old), employees who joined the Bank prior to 1 January 1998 and complete 10 years of service become eligible to the schemes. The employees who have joined the Bank after 1st January 1998 and complete 10 years of service become eligible for the new pension scheme. These Pension Schemes are non-contributory pension schemes where the cost of the 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. Eligible Employees under these plans who were recruited before 1 August 1994 contribute 5% of the monthly basic salary & employees who were recruited on or after 01 August 1994 10% of the monthly basic salary.

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 Schemes. In order to meet this liability, a provision is carried forward in the Statement of Financial Position, 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 (Mumbai) to re-assess the defined benefit obligations and the current service costs attributable to the Employees' Retirement Pension Schemes, 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 Schemes, Widows' and Orphans' Pension Scheme, Widowers' and Orphans' Pension Scheme are managed separately and separate books are maintained. However, Gratuity Scheme and 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 without being distributed.

The total fair value of plan assets of Rs. 40,816.60 Mn (2016 – Rs. 36,145.06 Mn) exceeds the total present value of all benefit obligations of Rs. 38,392.29 Mn (2016 – Rs. 36,065.09 Mn) at the end of the reporting period resulting in a surplus of Rs. 2,424.31 Mn (2016 – Rs. 79.97 Mn)

As at 31st December 2017

Benefit Liability/(Asset)	Employee Retirement Pension Scheme Rs. 000	Employee Retirement Pension Scheme - New 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 2017 Rs. 000
Present Value of Benefit Obligation	29,232,145	718,032	5,218,411	912,262	153,167	2,158,269	38,392,286
Fair Value of Plan Assets/Investments	(28,339,460)	(3,251,092)	(5,643,016)	(2,191,535)	(175,385)	(1,216,111)	(40,816,599)
Benefit Liability/ (Asset) non-current	892,685	(2,533,060)	(424,605)	(1,279,273)	(22,218)	942,158	(2,424,313)

The balance shown under Pension and Other Post Employment Benefit Plans in Statement of Financial Position differs from the net liability as per the actuary due to the following reasons:

- The net asset position of the Widows' and Orphans' Pension Scheme and Widowers' and Orphans' Pension Scheme are not reflected in the accounts due to the remote possibility of distributing any residual balance of the fund to the bank.
- For both gratuity and medical benefit schemes, the accounts represent the gross liability position and not the net liability as per actuary, since the Bank does not keep relevant assets in a separate fund (internally maintained).

There are uncollateralized investments under Pension, Widows' and Orphans' fund, Widowers' and Orphans' fund, Gratuity and Medical Benefit Scheme fund worth of Rs. 485.79 Mn for which 100% provision has been made and thus not included in the value of plan assets. Even without the value of such investments, bank has a net asset position under its pension liability as per actuarial valuation.

Movement in the Benefit Liability / (Asset)	Employee Retirement Pension Scheme Rs. 000	Employee Retirement Pension Scheme - New 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 2017 Rs. 000
At 1 January 2017	2,076,018	(1,834,772)	(187,705)	(1,002,453)	(20,646)	889,590	(79,968)
Benefit Expense	480,203	(208,897)	(24,402)	(130,319)	12,698	144,685	273,968
Amount recognized in Other Comprehensive Income	(1,017,607)	(308,404)	(180,379)	(136,612)	(14,270)	(84,350)	(1,741,622)
Contribution Paid	(645,929)	(180,987)	(32,119)	(9,889)	-	(7,767)	(876,691)
At 31 December 2017 - Non-Current	892,685	(2,533,060)	(424,605)	(1,279,273)	(22,218)	942,158	(2,424,313)

Benefit Expense	Employee Retirement Pension Scheme Rs. 000	Employee Retirement Pension Scheme-New 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 2017 Rs. 000
Interest Cost on Benefit Obligation	269,882	(238,520)	(24,402)	(130,319)	(2,684)	115,647	(10,396)
Current Service Cost	210,321	29,623	-	-	15,382	29,038	284,364
Benefit Expense	480,203	(208,897)	(24,402)	(130,319)	12,698	144,685	273,968
Actual Return on Plan Assets/ Investments	4,375,497	627,231	849,631	375,242	37,653	253,174	6,518,428
Actual Return on Plan Assets/ Investments as a % of Average Balance	16.28%	22.02%	15.75%	18.67%	22.97%	21.25%	16.94%
Excess of Interest Earned Over Benefit Paid	2,285,220	625,357	466,108	353,400	22,966	41,801	3,794,852
Changes in Fair Value of Plan Assets/ Investments	Employee Retirement Pension Scheme Rs. 000	Employee Retirement Pension Scheme-New 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 2017 Rs. 000
Fair Value of Plan Assets/ Investments at the beginning of the year	25,408,311	2,444,748	5,144,789	1,828,245	152,419	1,166,543	36,145,055
Actual Return on Plan Assets/ Investments	4,375,497	627,231	849,631	375,242	37,653	253,174	6,518,428
Contribution Received	645,929	180,987	32,119	9,889	-	7,767	876,691
Benefit Paid	(2,090,277)	(1,874)	(383,523)	(21,842)	(14,687)	(211,373)	(2,723,576)
Fair value of Plan Assets/ Investments at the end of the year	28,339,460	3,251,092	5,643,016	2,191,534	175,385	1,216,111	40,816,598
As at 31st December 2016							
Benefit Liability/(Asset)	Employee Retirement Pension Scheme Rs. 000	Employee Retirement Pension Scheme-New 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 2016 Rs. 000
Present Value of Benefit Obligation	27,484,329	609,976	4,957,084	825,792	131,774	2,056,133	36,065,088
Fair Value of Plan Assets / Investments	(25,408,311)	(2,444,748)	(5,144,789)	(1,828,245)	(152,419)	(1,166,543)	(36,145,055)
Benefit Liability/ (Asset) non-current	2,076,018	(1,834,772)	(187,705)	(1,002,453)	(20,645)	889,590	(79,967)
Movement in the Benefit Liability / (Asset)	Employee Retirement Pension Scheme Rs. 000	Employee Retirement Pension Scheme-New 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 2016 Rs. 000
At 1 January 2016	9,055,520	(1,245,041)	819,399	(612,924)	(33,574)	786,620	8,770,000
Benefit Expense	1,232,222	(72,429)	81,940	(61,292)	24,042	112,275	1,316,758
Amount recognized in Other Comprehensive Income	(7,765,143)	(345,098)	(1,055,189)	(316,344)	(11,113)	7,038	(9,485,849)
Contribution Paid	(446,581)	(172,204)	(33,855)	(11,893)	-	(16,343)	(680,876)
At 31 December 2016 - Non-Current	2,076,018	(1,834,772)	(187,705)	(1,002,453)	(20,645)	889,590	(79,967)

Benefit Expense	Employee Retirement Pension Scheme Rs. 000	Employee Retirement Pension Scheme-New 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 2016 Rs. 000
Interest Cost on Benefit Obligation	905,552	(124,504)	81,940	(61,292)	(3,358)	78,662	877,000
Past Service Cost	326,670	52,075	-	-	27,400	33,613	439,758
Benefit Expense	1,232,222	(72,429)	81,940	(61,292)	24,042	112,275	1,316,758
Actual Return on Plan Assets/ Investments	877,139	12,576	268,269	89,924	(6,438)	(37,029)	1,204,441
Actual Return on Plan Assets/ Investments as a % of Average Balance	3.40%	0.53%	5.17%	5.03%	-3.89%	-2.91%	3.30%
Excess of Interest Earned Over Benefit Paid	(1,158,329)	12,576	(114,825)	69,041	(25,769)	(231,229)	(1,448,535)
Changes in Fair Value of Plan Assets / Investments	Employee Retirement Pension Scheme Rs. 000	Employee Retirement Pension Scheme -New 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 2016 Rs. 000
Fair Value of Plan Assets/Investments at the beginning of the year	26,120,059	2,259,968	5,225,759	1,747,311	178,188	1,381,429	36,912,714
Actual Return on Plan Assets/ Investments	877,139	12,576	268,269	89,924	(6,438)	(37,029)	1,204,441
Contribution Received	446,581	172,204	33,855	11,893	-	16,343	680,876
Benefits Paid	(2,035,468)	-	(383,094)	(20,883)	(19,331)	(194,200)	(2,652,976)
Fair value of Plan Assets/ Investments at the end of the year	25,408,311	2,444,748	5,144,789	1,828,245	152,419	1,166,543	36,145,055

The principal assumptions used in determining Employee Benefit Obligations for all the plans are shown below:

	2017	2016
Discount Rate	13.00%	13.00%
Expected Rate of Return on Assets	13.00%	13.00%
Future Salary Increases	8.50%	8.50%
Rate of Salary Increase - Pension New	6.50%	6.50%
Future Pension Increases	7.50%	7.50%
Attrition Rate	2.00%	2.00%
Medical Cost Inflation Rate	3.00%	3.00%
Average Remaining years of Service		
CBSL Pension	27 Years	27 Years
CBSL Pension - New	41 Years	41 Years
W & OP Pension Scheme	27 Years	27 Years
WR & OP Pension Scheme	27 Years	27 Years
Gratuity Scheme	20 Years	20 Years
CBSL Medical Benefit Scheme	32 Years	32 Years
Retirement Age	60 Years	60 Years

Sensitivity Analysis at 0.5% (31-12-2017)	Employee Retirement Pension Scheme Rs. 000	Employee Retirement Pension Scheme-New 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
Projected benefit obligation on current assumptions	29,232,145	718,032	5,218,411	912,262	153,167	2,158,269
Effect of "+" change in discount rate	(1,191,585)	(74,437)	(235,086)	(51,577)	(5,314)	(69,405)
Effect of "-" change in discount rate	1,284,348	84,978	256,050	56,341	5,668	74,344
Effect of "+" change in attrition rate	-	-	-	-	30,610	13,365
Effect of "-" change in attrition rate	-	-	-	-	(33,377)	(14,060)
Effect of "+" change in salary escalation rate	163,917	64,085	12,735	5,293	5,883	-
Effect of "-" change in salary escalation rate	(159,677)	(58,265)	(12,410)	(5,165)	(5,551)	-
Effect of "+" change in Medical Cost Inflation	-	-	-	-	-	75,512
Effect of "-" change in Medical Cost Inflation	-	-	-	-	-	(70,491)
Effect of "+" change in Rate of Pension Escalation	1,173,562	-	254,555	53,360	-	-
Effect of "-" change in Rate of Pension Escalation	(1,101,245)	-	(236,091)	(49,459)	-	-

30. 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.

31. EQUITY

Nature of Equity Items

31.1 Capital Funds

Contributed Capital - The capital account represents the capital of the Bank in accordance with section 6 of the Monetary Law Act (MLA). As per the section 6 of the MLA (Amendment) Act No. 15 of 2014, the capital of the Bank has been increased to Rs. 50 Bn. Accordingly, Bank has increased its capital up to Rs. 50 Bn by capitalizing the Bank's reserves with the concurrence of Minister of Finance in September 2014.

31.2 Fixed Asset Revaluation Reserve – This reserve is made up of the revaluation surpluses of Property, Plant and Equipment as per IAS 16.

31.3 Other Reserves comprise the following;

- i). **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 IRR.
- ii). **Market Revaluation Reserve (MRR)**: Market Revaluation Reserve 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 Bank.

Further, as per the Monetary Board decision MB/DG (W)/7/1/2016 dated 29 February 2016 on proposed amendments to the Profit Distribution Policy of the Bank, where Monetary Board deems necessary, transfer may be made from the MRR to Retained Earnings, in the case of negative Retained Earnings due to significant unrealized marked to market losses.

Accordingly, an amount of Rs.4.65 Bn has been transferred to Retained Earnings from MRR in view of improving the negative Retained Earnings of the Bank which has resulted mainly due to the accumulation of

significant unrealized marked to market losses in the past years.

Considering the subsequent marked to market gains, an amount of Rs. 14.03 bn was transferred to MRR from Retained Earnings in 2017 as per the Monetary Board decision BP MB/F/7/21/2017 dated 20 February 2017.

- iii). **Other Reserves** : Other reserves include General Reserve, Building Reserve and Credit Guarantee Reserve. General Reserve includes the amounts set aside from the retained earnings by the Monetary Board.
- iv). **Net Fair Value Gain/(Loss) on Available for Sale Securities** : Unrealized gains and losses on the revaluation of securities and unit investments designated as available for sale are transferred to this reserve.
- v). **RTGS Sinking Fund** : This fund is built up with the charges collected from the participants for the use of the RTGS system.
- vi). **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. Another Rs. 1 Bn have been transferred to this reserve from 2011 profits. During June 2015, Rs. 2 Bn has been transferred from Pension Fund Reserve to New Pension Liability Account to implement the new pension scheme as per Board Paper No: MB/HR/11/12/2015.
- vii). **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 Bank i.e., General Ledger, RTGS, Treasury Management System and Scriptless Securities Settlement System.
- viii). **Provincial Development Credit Scheme** : During 2010, the 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.2.90 Bn. Such loans are granted through Bank of Ceylon & People's Bank.
- ix). **Special Credit Guarantee Scheme Reserve** : This reserve was set up in the year 2014 by transferring Rs. 2 Bn from Medium and Long Term Credit Fund, of which Rs. 1 Bn is allocated to support restructure of Saubaghya Loan Scheme, Awakening North Loan Scheme (phase II), Resumption of Economic Activities in the East (phase II) and Repair of Damaged Houses in North and East operated by Regional Development Department of the Bank. The balance of Rs. 1 Bn is allocated to implement a special credit guarantee scheme to support lending to Small and Medium Enterprises by Commercial Banks.

The movements in the other reserves are as follows:

	Medium and Long Term Credit Reserve Rs. 000	Market Revaluation Reserve Rs. 000	Other Reserves Rs. 000	Special Credit Guarantee Scheme Reserve Rs. 000	RTGS Sinking Fund Rs. 000	IRR Rs. 000	Net Fair Value Gain/ (Loss) on Available for Sale Securities Rs. 000	Pension Fund Reserve Rs. 000	Technical Advancement Reserve Rs. 000	Provincial Development Credit Scheme Fund Rs. 000	Reserve for funding purposes of post employment benefit plans Rs. 000	Total Rs. 000
As at 1 January 2017	2,925,000	-	2,489,920	2,000,000	1,552,900	12,381,876	3,280,813	2,000,000	1,000,000	2,900,000	-	30,530,509
Transfer to RTGS Sinking Fund	-	-	-	-	273,918	-	-	-	-	-	-	273,918
Transfer of Profits to General Reserve	-	-	7,462,613	-	-	-	-	-	-	-	-	7,462,613
Transfer of balance remaining in Susahana Loan Scheme Fund to General Reserve	(1,000,000)	-	1,000,000	-	-	-	-	-	-	-	-	-
Transfer of Net Foreign Exchange Revaluation Loss	-	-	-	-	-	(3,808,147)	-	-	-	-	-	(3,808,147)
Net Fair Value Gain / (Loss) on Available for Sale Securities	-	-	-	-	-	-	(6,843,970)	-	-	-	-	(6,843,970)
Transfer of Funds to Market Revaluation Reserve	-	14,028,792	-	-	-	-	-	-	-	-	-	14,028,792
Transfer to Reserve for funding purposes of Post-Employment Benefit	-	-	-	-	-	-	-	-	-	-	689,025	689,025
As at 31 December 2017	1,925,000	14,028,792	10,952,533	2,000,000	1,826,818	8,573,729	(3,563,157)	2,000,000	1,000,000	2,900,000	689,025	42,332,740

32. PROFIT DISTRIBUTION

In terms of the Monetary Law Act and Monetary Board approved Profit Distribution Policy of CBSL (effective from 2015), the following adjustments are made to the IFRS net profit/(loss) for the year in order to arrive at the distributable profit.

- Remove the exchange gain /(loss) (Sec. 41 of Monetary Law Act).
- Remove gains from Unrealized Price Revaluations (unrealized "marked to market" gains) but charge losses from Unrealized Price Revaluations (unrealized "marked to market" losses) (As per the Profit Distribution Policy of CBSL)
- Any other transfers to reserves as per Sec.38 of MLA and any other adjustments arising from Sec. 39 of MLA as decided by the Monetary Board.

Further, any other adjustment as required by accounting standards and management decisions are adjusted in arriving at the distributable profit.

Based on the above adjustments, the distributable profit for the year ended 31st December 2017 is as follows:

Item	2017 Rs. 000
Profit for the year	48,356,367
Less:	
Transfer of exchange losses to IRR in accordance with the MLA	(3,808,147)
Transfer of "marked to market" gain on foreign assets to Market Revaluation Reserve (MRR)	24,337,841
Other accounting adjustments	440,627
Distributable Profit/(Loss) as per MLA, Profit Distribution Policy of the Bank and other adjustments - Realised Profit/(Loss)	27,386,046
Transfer to Reserves (Sec. 38 of MLA)	
Transfer to Reserve for funding purpose of Post Employment Benefit Plans	5,372,178
-Transfer to the technical advancement reserve	2,000,000
-Transfer to general reserve	5,013,868
-Recovery of outstanding GOSL obligations (Sec. 39 of MLA)	772,903
Amount Credited to the Consolidated Fund (Sec. 39 of MLA)	14,227,097

33. INTEREST INCOME FROM FINANCIAL ASSETS

	2017 Rs. 000	2016 Rs. 000
Interest Income from Foreign Currency Financial Assets		
Cash and Short Term Deposits	2,760,599	1,479,882
Financial Assets	6,170,100	4,628,934
Derivatives	13,984,017	8,761,019
Total Interest Income from Foreign Currency Financial Assets	22,914,716	14,869,835
Interest Income from Local Currency Financial Assets		
Sri Lanka Government Securities	17,923,374	20,333,567
Other Loans and Advances	845,554	687,124
Total Interest Income from Local Currency Financial Assets	18,768,928	21,020,691
Total Interest Income from Financial Assets	41,683,644	35,890,526

34. GAIN/(LOSS) FROM UNREALIZED PRICE REVALUATIONS

	2017 Rs. 000	2016 Rs. 000
Foreign Securities	(61,814)	3,166
Gold	13,949,169	8,306,063
Forex & Currency SWAPS	9,702,099	5,719,563
Interest Rate Swaps	-	(1,637)
Currency Options	411,021	(4,288,112)
Total Gain/(Loss) from Unrealized Price Revaluations	24,000,475	9,739,043

35. INTEREST EXPENSE ON FINANCIAL LIABILITIES

	2017 Rs. 000	2016 Rs. 000
Interest Expense on Foreign Currency Financial Liabilities		
Amount Payable to Asian Clearing Union	467,828	174,504
IMF Related Liabilities	1,900,742	1,180,604
Derivatives	210,877	396
Other Foreign Payable	383,784	2,598,331
Total Interest Expense on Foreign Currency Financial Liabilities	2,963,231	3,953,835
Interest Expense on Local Currency Financial Liabilities		
Securities Sold Under Agreements to Repurchase	1,023,720	345,835
Standing Deposit Facility	1,195,866	1,519,585
Bond Borrowing	1,716	-
Abandoned Property	454,814	332,395
Total Interest Expense on Local Currency Financial Liabilities	2,676,116	2,197,815
Total Interest Expense on Financial Liabilities	5,639,347	6,151,650

Bank has a net sterilization gain of Rs. 12,977.01 Mn (2016 - Rs. 9,366.62 Mn) in its activities to inject the liquidity to the market due to the deficit liquidity position. The sterilization cost is composed of the interest expenses incurred on securities sold under agreement to repurchase, interest expense on Bond Borrowing and interest expense on Standing Deposit Facility netted off with interest income earned on the securities purchased under agreement to resale (Reverse Repurchase) included under interest income from Sri Lanka Government Securities and USD/LKR Derivative gain included in the Derivative gain under interest income from foreign currency financial assets, as discussed below:

	2017 Rs. 000	2016 Rs. 000
Interest expenses incurred on securities sold under agreement to repurchase	1,023,720	345,835
Interest expense on Bond Borrowing	1,716	-
Interest expense on Standing Deposit Facility	1,195,866	1,519,585
Less:		
Interest income earned on the securities purchased under agreement to resale	1,214,298	2,471,022
USD / LKR Derivative Gain	13,984,017	8,761,019
	12,977,013	9,366,621

36. OTHER INCOME

	2017 Rs. 000	2016 Rs. 000
Dividend Income - Related Party	104,601	37,259
- Others	2,540	1,818
Gain/(Loss) Disposal of Property, Plant & Equipment	(732)	424
Amortization of Deferred Grant	34	34
Licensing Fees of Financial Institutions	555,975	519,900
Rent Income	485,515	455,514
Charges collected from RTGS Participants	119,606	112,863
Miscellaneous Income	335,125	380,449
Total Other Income	1,602,664	1,508,261

Miscellaneous income includes amortization gain of Rs.1.59 Mn (2016 - Rs. 1.40 Mn) on debentures in Sri Lanka Savings Bank Ltd and Rs. 6.80 Mn (2016 - Rs. 6.17 Mn) of gain on amortization of PRGF Deposit of SDR 788,783 with IMF over remaining period of one year (Note 08).

37. PERSONNEL EXPENSES

	2017 Rs. 000	2016 Rs. 000
Wages and Salaries	4,112,349	4,258,884
Defined Contribution Plan Costs	610,489	629,786
Post Employee Defined Benefit Plan Costs	744,356	1,479,963
Total Personnel Expenses	5,467,194	6,368,633

38. ADMINISTRATION AND OTHER EXPENSES

	2017 Rs. 000	2016 Rs. 000
Repairs and Maintenance	796,595	773,239
Operating Expenses for Reuters, Bloomberg, SWIFT etc.	122,260	134,648
Travelling	114,217	116,658
Rental Expenses	3,325	4,994
Printing	27,728	27,468
Audit Fees	10,412	7,846
Remuneration to Members of the Monetary Board	4,463	3,605
Interest Subsidy on CBSL Provident Fund	-	47,877
Advertising Cost	36,045	80,519
Consultancy, Communication, Advisory and Professional Fees	87,020	68,058
Miscellaneous Expenses	103,584	200,672
Total Administration and Other Expenses	1,305,649	1,465,584

39. WITHHOLDING TAX

Bank is not liable for the income tax as per the Inland Revenue (Amendment) Act No. 10 of 2006 section 7b (xvi) and the Withholding Tax paid by the Bank is treated as the final tax paid to the Inland Revenue Department (IRD).

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 year 2017, an amount of Rs. 1,837.96 Mn (2016 - Rs. 1,834.35 Mn) was expensed in relation to such withholding tax, payable on interest income of Rs. 20,094.54 Mn (2016 - Rs. 15,623.62 Mn) and dividend income of Rs. 107.14 Mn (2016 - Rs. 39.08 Mn).

40. RECONCILIATION OF OPERATING PROFIT WITH OPERATING CASH FLOW

	2017 Rs. 000	2016 Rs. 000
Reported Profit from Operating Activities	48,356,368	22,179,519
Add / (Less) Non-Cash Items		
Depreciation & Amortization	518,716	520,961
Interest Received – Local Currency – Investment Portfolio	(17,911,410)	(20,333,567)
Bad Debts written Back	(27,302)	-
Gross Unrealised Foreign Exchange (Gain) / Loss	(9,595,724)	(12,107,722)
Profit on Sale of Property, Plant and Equipment	-	(1,400)
Provisions and Accruals	725,778	2,713,774
Deferred Grants	(34)	(27)
Losses on revaluation	-	378,907
Amortization of PRGF Deposit	(6,804)	(6,165)
Amortization expense of Fixed Income Securities	883,659	807,349
Add/ (Less) Movements in Other Working Capital Items		
(Increase)/Decrease in Inventories	(760,672)	(2,694,897)
(Increase)/Decrease in Interest Receivable	579,464	(4,576,657)
Increase / (Decrease) in Miscellaneous Liabilities	906,181	(723,637)
Increase / (Decrease) in Interest Payable	219,716	32,460
(Increase)/Decrease in Other Receivable	(79,675)	(26,455)
Add / (Less) Investing and Financing Activities		
Net Unrealised Market Value Changes	(25,110,720)	(9,857,403)
Net Cash Flow from Operating Activities	(1,302,459)	(23,694,960)

41. NET ISSUES/(WITHDRAWALS) OF CIRCULATION CURRENCY ON GOVERNMENT TRANSACTIONS

	2017 Rs. 000	2016 Rs. 000
Purchases of Sri Lanka Government Securities	(315,960,919)	246,320,577
Interest Received – Local Currency – Sri Lanka Government Securities	(21,308,838)	(18,094,641)
Increase / (Decrease) in Advances to GOSL	116,494,100	(67,824,900)
(Increase) / Decrease in Balances with Government and Government Entities	126,367	(22,741)
	(220,649,290)	160,378,295

42. NET ISSUES/(WITHDRAWALS) OF CIRCULATION CURRENCY ON BANK AND FINANCIAL INSTITUTIONS TRANSACTIONS

	2017 Rs. 000	2016 Rs. 000
(Increase)/Decrease in Deposits by Banks and Financial Institutions	(38,460,908)	(121,524,559)
	(38,460,908)	(121,524,559)

43. CLOSING CASH AND CASH EQUIVALENTS

	2017 Rs. 000	2016 Rs. 000
Foreign Currency Assets		
Cash Balances with Foreign Banks	459,827,641	423,783,737
	459,827,641	423,783,737

44. CONCENTRATIONS OF FUNDING

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	Supranational Financial Institutions Rs. 000	Other Rs. 000
44.1 Balance as at 31 December 2017						
Foreign Currency Financial Liabilities						
Banks and Financial Institutions	8,683,033	-	-	-	329,937	8,353,096
Derivative Financial Instruments	4,648,449	-	-	4,648,449	-	-
Asian Clearing Union	90,868,160	-	-	-	90,868,160	-
IMF	318,665,332	-	-	-	318,665,332	-
Other	64,095,889	17,848,687	-	1,193,019	200,757	44,853,426
Total Foreign Currency Financial Liabilities	486,960,863	17,848,687	-	5,841,468	410,064,186	53,206,522
Local Currency Financial Liabilities						
Deposits of Banks and Financial Institutions	341,712,198	-	-	341,707,391	-	4,807
Deposits of Government and Government Entities	324,517	324,515	2	-	-	-
Securities Sold Under Repurchase Agreements	40,655,278	-	-	40,655,278	-	-
Balances of Employee Benefit Plans	4,547	-	-	-	-	4,547
Currency in Circulation	598,053,901	-	598,053,901	-	-	-
Other Payables	8,887,156	45,734	-	2,306,897	-	6,534,525
Total Local Currency Financial Liabilities	989,637,597	370,249	598,053,903	384,669,566	-	6,543,879
Total Financial Liabilities	1,476,598,460	18,218,935	598,053,903	390,511,035	410,064,186	59,750,401
Other Liabilities						
Deferred Grants	45	-	-	-	-	45
Pension and Other Post Employment Benefit Plans	671,061	-	-	-	-	671,061
Miscellaneous Liabilities and Accruals	211,720	82,328	-	-	-	129,392
Total Other Liabilities	882,826	82,328	-	-	-	800,498
Total Liabilities	1,477,481,286	18,301,263	598,053,903	390,511,035	410,064,186	60,550,899
44.2 Balance as at 31 December 2016						
Foreign Currency Financial Liabilities						
Banks and Financial Institutions	45,566,681	-	-	-	180,696	45,385,985
Derivative Financial Instruments	14,573,675	-	-	14,573,664	11	-
Asian Clearing Union	79,863,615	-	-	-	79,863,615	-
IMF	269,540,596	-	-	-	269,540,596	-
Other	96,250,032	34,417,259	-	1,169,177	440,328	60,223,268
Total Foreign Currency Financial Liabilities	505,794,599	34,417,259	-	15,742,841	350,025,246	105,609,253
Local Currency Financial Liabilities						
Deposits of Banks and Financial Institutions	303,251,290	-	-	293,896,364	-	9,354,926
Deposits of Government and Government Entities	450,884	450,837	47	-	-	-
Securities Sold Under Repurchase Agreements	70,054,436	-	-	67,552,907	-	2,501,529
Balances of Employee Benefit Plans	51,744	-	-	-	-	51,744
Currency in Circulation	552,777,865	-	552,777,865	-	-	-
Other Payable	8,563,548	46,218	-	182,000	-	8,335,330
Total Local Currency Financial Liabilities	935,149,767	497,055	552,777,912	361,631,271	-	20,243,529
Total Financial Liabilities	1,440,944,366	34,914,314	552,777,912	377,374,112	350,025,246	125,852,782
Other Liabilities						
Deferred Grants	80	-	-	-	-	80
Pension and Other Post Employment Benefit Plans	2,429,153	-	-	-	-	2,429,153
Miscellaneous Liabilities and Accruals	193,297	62,449	-	-	-	130,848
Total Other Liabilities	2,622,530	62,449	-	-	-	2,560,081
Total Liabilities	1,443,566,896	34,976,763	552,777,912	377,374,112	350,025,246	128,412,863

45. RISK MANAGEMENT

The Central Bank of Sri Lanka (CBSL) has two statutory objectives, i.e., economic and price stability and financial system stability. The CBSL has been assigned with wide statutory powers to implement economic and financial policies to secure its objectives. The Monetary Board, the Governing Board of the CBSL is responsible for making all policy decisions related to the management, operations and administration of the Bank. The CBSL's operations and policies are not aimed towards generating profits. However, it is exposed to a number of risks in the course of carrying out its functions. Therefore, the bank's management ensures that strong and effective risk management and control systems are in place. In this regard, the Monetary Board has delegated the task of risk management to departments and committees with a view to

ensure effective management and control of risks. Therefore, risk management is a responsibility of all levels of decision making at the CBSL.

Managing risks at the CBSL is conducted under a 'Three Lines of Defense' model. Accordingly, the responsibility of the 'First Line of Defense' rests with the respective departments. The risks coming under the 'First Line of Defense' are operational in nature, so that such risks are managed by departments where they are originated. The 'First Line of Defense' would ensure proper internal risk management systems and controls are in place. The Risk Management Department (RMD) as the 'Second Line of Defense' is responsible for assessing, controlling and monitoring

of financial risks and independently reporting to the Governor. Internal Audit Department is entrusted with the responsibility of performing the risk assurance function as the 'Third Line of Defense'.

The two major dimensions of risks are financial risks and non-financial risks. Financial Risk includes market risk (interest rate risk and foreign exchange risk), credit risk and liquidity risk. The RMD carries out risk assessments, monitoring and reporting of financial risks relating to the CBSL's foreign reserves portfolio while the International Operations Department (IOD) of the CBSL manages the foreign reserves portfolio. A comprehensive set of guidelines incorporating risk mitigation policies are followed by IOD in managing reserves portfolio. Financial risk assessments relating to international reserves are independently reported to the Governor and the Monetary Board.

Interest rate risk or the exposure of the Bank's foreign assets portfolio to movements in the interest rate is monitored through modified duration of the portfolio as well as Value at Risk (VaR) for a time horizon of 10 days and a confidence level of 99 per cent. 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 order to mitigate liquidity risk, limits to assets classes, a maximum purchasing limit over total amount issued by the issuers of the securities are considered in the Strategic Assets Allocation (SAA). 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 45.1, 45.2, 45.3, 45.4 and 45.5 respectively.

A Counterparty Credit Risk Management System (CCRMS) is used to manage the credit risk of the foreign assets portfolio based on the credit ratings of the investments and the counterparties. In addition, Money Market Counterparties' Credit Default Swaps (CDS) /Stock prices are monitored by the RMD on a continuous basis.

Assessing, monitoring and reporting of financial risk pertaining to investments by internal investment funds of the Central Bank also carries out by the RMD. Internal Investment Fund of the CBSL is currently managed under the Finance Department as the "Front Office" and the RMD monitors the risks pertaining to the investments of the internal fund on an ongoing basis. RMD submits status reports of the fund independently to the Governor on an ongoing basis, provides Finance Department with risk related inputs to improve the Investment Process and Investment Policy Statement, etc., to ensure capital preservation and the adequacy of liquidity of the fund at all times.

Non-Financial risk includes legal risk, compliance risk, human resource risk, fraud risk, strategic and policy risk and other operational risks etc. Monitoring non-financial risk would ensure a risk compliance of work procedures, rules and guidelines as well as proper risk governance of the bank. In view of the above, 17 selected departments submit their non-financial risk profiles to RMD on periodic basis, and information submitted by these departments are compiled and analyzed by RMD and presented to the senior management.

The internal controls and the risk management processes are audited annually by the Internal Audit Department (IAD) 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 IAD reports administratively to the Governor who is the chairman of the Monetary Board and functionally to the Monetary Board Advisory Audit Committee (AAC).

AAC is chaired by an appointed member of the Monetary Board. AAC advises the Monetary Board on matters relating to the integrity of the financial statements of the Bank, including its annual and any other reports, interim management statements and any

other formal announcements relating to its financial performance, reviewing significant financial reporting issues and judgements which they contain; internal controls and risk management systems; the adequacy and effectiveness of the compliance function of the Bank; the effectiveness of the internal audit function of the Bank and related matters; and external audit related matters. The recommendations of AAC and progress of IAD are reported to the Monetary Board quarterly.

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 KPMG. to carry out an audit under International Standards of Auditing to ensure compliance with the International Financial Reporting Standards.

45.1 Credit Risk

(a) Concentrations of credit Exposure by geographical area

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:

	2017 Rs. 000	2016 Rs. 000
Sri Lanka	249,968,143	450,197,249
USA	643,710,289	238,171,318
Japan	18,253,104	42,458,692
Britain	28,946,605	53,470,593
Europe	94,190,661	130,405,122
Supranational	273,831,693	373,327,138
Other	142,897,782	98,710,669
Total Financial Assets	1,451,798,277	1,386,740,780

(b) Concentrations of Credit Exposure by Institutions

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

	2017 Rs. 000	2016 Rs. 000
Governments	958,345,205	844,074,103
Supranational Financial Institutions	273,831,693	373,327,138
Foreign Banks and Financial Institutions	201,640,454	159,700,398
Banks & Financial Institutions in Sri Lanka	10,308,545	3,885,700
Other	7,672,380	5,753,441
Total Financial Assets	1,451,798,277	1,386,740,780

(c) Credit Exposure by Credit Rating

The following table represents the credit ratings of respective financial assets or issuers, based on the ratings of Standard and Poor's and Fitch 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 that Standard and Poor's or Fitch Rating have not rated the entity.

Credit Exposure by Credit Rating		Credit Rating	2017 Rs.000	%	2016 Rs.000	%
Cash & Cash Equivalents						
Federal Reserve Bank - USA/Reserve Bank of Australia/Bank for International Settlements/Bank of Japan/Deutsche Bundesbank/Bank of England/Sveriges Riks Bank/Bank of Canada/Reserve Bank of New Zealand			310,350,210	21.38%	310,794,899	22.41%
	AAA	50,158,566	3.45%	53,182,289	3.84%	
	AA	772,746	0.05%	7,536	0.00%	
	AA-	81,500,623	5.61%	50,185,913	3.62%	
	A+	3,032,823	0.21%	8,002,830	0.58%	
	A	13,741,004	0.95%	946,070	0.07%	
	A-	84,841	0.01%	138,110	0.01%	
	BBB+	-	0.00%	37	0.00%	
	BBB-	1,505	0.00%	29,187	0.00%	
	NR	185,323	0.01%	496,866	0.04%	
		459,827,641	31.67%	423,783,737	30.56%	
Available for Sale Securities						
Federal Reserve Bank - USA/Reserve Bank of Australia/Bank for International Settlements/ Bank of Japan/Deutsche Bundesbank/Bank of England/Sveriges Riks Bank/Bank of Canada/Reserve Bank of New Zealand			-	0.00%	8,820,628	0.64%
	AAA	62,060,643	4.27%	99,753,201	7.19%	
	AA+	464,672,544	32.01%	183,643,987	13.24%	
	AA	1,862,308	0.13%	1,621,201	0.12%	
	AA-	13,360,972	0.92%	18,981,776	1.37%	
	A+	21,867,283	1.51%	22,734,638	1.64%	
	A	298,956	0.02%	3,119,014	0.22%	
	A-	-	0.00%	(120,419)	-0.01%	
	NR	2,106,229	0.15%	9,990,623	0.72%	
		566,228,935	39.00%	348,544,650	25.13%	
Securities at Fair Value Through Profit or Loss						
	AAA	23,517,574	1.62%	23,455,657	1.69%	
	AA+	1,393,767	0.10%	1,620,526	0.12%	
	AA	3,593,798	0.25%	2,902,494	0.21%	
	AA-	1,174,551	0.08%	1,586,037	0.11%	
	A+	309,062	0.02%	(224,716)	-0.02%	
	A	15,275,623	1.05%	13,396,168	0.97%	
	BBB+	-	0.00%	542,589	0.04%	
		45,264,376	3.12%	43,278,755	3.12%	
Derivative Financial Instruments						
Locally Rated						
	AAA	979,560	0.07%	-	0.00%	
	AA+	-	0.00%	2,377	0.00%	
	AA	2,749,069	0.19%	156,660	0.01%	
	AA-	481,327	0.03%	39,843	0.00%	
	A+	66,030	0.00%	-	0.00%	
	A	64,099	0.00%	-	0.00%	
	A-	387,706	0.03%	-	0.00%	
	B	24,265	0.00%	-	0.00%	
	NR	188,399	0.01%	-	0.00%	
		4,940,455	0.33%	198,880	0.01%	
IMF Related Assets						
	AAA	126,838,152	8.74%	117,008,339	8.44%	
		126,838,152	8.74%	117,008,339	8.44%	
Other Receivables						
	AAA	4,794	0.00%	532	0.00%	
	AA+	3,072,381	0.21%	-	0.00%	
	AA-	-	0.00%	2,299,102	0.17%	
	A+	-	0.00%	224,742	0.02%	
	A	-	0.00%	127	0.00%	
	A-	-	0.00%	120,772	0.01%	
	BBB+	-	0.00%	237,320	0.02%	
Locally Rated						
	AAA	-	0.00%	2,247,000	0.16%	
	NR	593,319	0.04%	1,045,455	0.08%	
		3,670,494	0.25%	6,175,049	0.45%	
Total Foreign Currency Financial Assets			1,206,770,053	83.12%	938,989,411	67.71%

	Credit Rating	2017 Rs.000	%	2016 Rs.000	%
Local Currency Financial Assets					
Sri Lanka Government Securities	B+	32,080,086	2.21%	351,426,470	25.34%
Provisional Advances to Government	B+	199,800,871	13.76%	83,306,771	6.01%
Loans to Banks	AA+	96,025	0.01%	244,284	0.02%
	AA	2,056	0.00%	4,040	0.00%
	AA-	2,493	0.00%	7,902	0.00%
	A+	8,218	0.00%	17,775	0.00%
	A-	14,624	0.00%	25,195	0.00%
	BBB	1,449	0.00%	3,626	0.00%
	BB+	39,692	0.00%	62,341	0.00%
	B+	-	0.00%	515	0.00%
	B	2,140	0.00%	3,500	0.00%
	NR	57,006	0.00%	114,865	0.01%
Equity Investments in Financial and Other Institutions	NR	41,095	0.00%	41,095	0.00%
Other Assets	AAA	135,457	0.01%	811	0.00%
	AA+	919,142	0.06%	548,609	0.04%
	AA	-	0.00%	167,860	0.01%
	A	6,746	0.00%	6,639	0.00%
	B+	5,443,809	0.37%	5,824,867	0.42%
	B	-	0.00%	10,317	0.00%
	NR	6,377,316	0.44%	5,933,887	0.43%
Total Local Currency Financial Assets		245,028,224	16.88%	447,751,369	32.29%
Total Financial Assets		1,451,798,277	100.00%	1,386,740,780	100.00%
(d) Summary by Major Credit Category					
Foreign Currency Financial Assets					
Federal Reserve Bank - USA/Reserve Bank of Australia/Bank for International Settlements/ Bank of Japan/ Deutsche Bundesbank/Bank of England/ Sveriges Riks Bank/Bank of Canada/Reserve Bank of New Zealand		310,350,210	21.38%	319,615,527	23.05%
IMF Related Assets		126,838,152	8.74%	117,008,871	8.44%
	AAA	135,741,577	9.35%	176,391,148	12.72%
	AA+/-	571,403,690	39.36%	262,848,573	18.95%
	A+/-	54,609,592	3.76%	48,337,336	3.49%
	BBB+/-	1,505	0.00%	809,132	0.06%
	NR	2,291,553	0.16%	10,487,489	0.76%
Locally Rated	AAA	979,560	0.07%	2,247,000	0.16%
	AA+	-	0.00%	2,377	0.00%
	AA	2,749,069	0.19%	156,660	0.01%
	AA-	481,327	0.03%	39,843	0.00%
	A+/-	517,835	0.04%	-	0.00%
	B	24,265	0.00%	-	0.00%
	NR	781,718	0.05%	1,045,455	0.08%
Total Foreign Currency Financial Assets		1,206,770,053	83.12%	938,989,411	67.71%
Local Currency Financial Assets	AAA	135,457	0.01%	811	0.00%
	AA+	1,015,167	0.07%	792,893	0.06%
	AA	2,056	0.00%	171,900	0.01%
	AA-	2,493	0.00%	7,902	0.00%
	A+	8,218	0.00%	17,775	0.00%
	A	6,746	0.00%	6,639	0.00%
	A-	14,624	0.00%	25,195	0.00%
	BBB	1,449	0.00%	3,626	0.00%
	BB+	39,692	0.00%	62,341	0.00%
	B+	237,324,767	16.35%	440,558,623	31.77%
	B	2,140	0.00%	13,817	0.00%
	NR	6,475,417	0.45%	6,089,847	0.44%
Total Local Currency Financial Assets		245,028,224	16.88%	447,751,369	32.29%
Total Financial Assets		1,451,798,277	100.00%	1,386,740,780	100.00%

45.2 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, except the investment in Reserve Advisory Management Program (RAMP), 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 (USD Mn)	
	2017	2016
Trading and Available for Sale	7.55	5.16
RAMP	0.03	0.03

RMD 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 interest rates on the foreign assets portfolio, the Bank 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 sets an appropriate MD from time to time considering the developments in the financial markets, portfolio characteristics and the risk appetite of the bond portfolio. The MDs of the foreign assets portfolio are tabulated below:

Modified Duration

Investment Segment	Modified Duration	
	2017	2016
Capital Market (Fixed Income Securities)	2.02	2.26
RAMP	1.39	1.42

- ii) Since the MD 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.

Convexity of the segmented Fixed Income Securities portfolio

Portfolio Segment	Potential Loss (USD Mn)	
	2017	2016
Trading and Available for Sale	0.07	0.99
RAMP	0.04	0.04

iii) Value at Risk (VaR)

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. VaR gives a number, in terms of money, which can be aggregated across risks and positions. The Bank uses historical simulation method to calculate VaR number for 10 days period at 99% confidence interval. The historical method for estimating VaR is sometimes referred to as the historical simulation method. As an example to calculate the 5% daily VaR using the historical method is to accumulate a number of past daily returns, rank the returns from highest to lowest, and identify the lowest 5% of returns. The highest of these lowest 5% of returns is the 1-day, 5% VaR.

Portfolio Segment	Value at Risk (VaR) USD Mn	
	2017	2016
Trading and Available for Sale	22.98	36.02
RAMP	0.64	0.65

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".

Interest rate risk measures related to the investments in the Reserve Advisory Management Program (RAMP) is reported to the Foreign Reserve Management Committee on a regular basis.

(b) Local Currency Interest Rate Sensitivity

The local Treasury Bill portfolio is recorded in the Statement of Financial Position of the Bank 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, 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, 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 Bank's 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

(c) Assets and liabilities will mature or re-price within the following Periods							
Foreign Currency Interest Rate Sensitivity Gap:	Weighted Avg. Int. Rate %	2017 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
Interest Sensitive Foreign Currency Financial Assets							
Cash & Cash equivalents	1.5150	459,827,641	459,827,641	-	-	-	-
Securities at Fair Value through Profit or Loss and Available for Sale Investments	1.9158	596,217,687	87,922,743	76,479,327	118,516,346	313,299,271	-
IMF related assets	0.5392	11,094,542	11,094,542	-	-	-	-
Total Interest Sensitive Foreign Currency Financial Assets		1,067,139,870	558,844,926	76,479,327	118,516,346	313,299,271	-
Non Interest Sensitive Foreign Currency Financial Assets							
IMF Related assets		115,743,610	-	164,564	-	-	115,579,046
Derivative Financial Instruments		4,940,455	4,536,892	403,563	-	-	-
Other Receivables		3,670,494	3,670,494	-	-	-	-
Securities at Fair Value through Profit or Loss		15,275,623	15,275,623	-	-	-	-
Total non Interest Sensitive Foreign Currency Financial Assets		139,630,182	23,483,009	568,127	-	-	115,579,046
Total Foreign Currency Financial Assets		1,206,770,052	582,327,935	77,047,454	118,516,346	313,299,271	115,579,046
Interest Sensitive Foreign Currency Financial Liabilities							
IMF	1.5480	116,996,460	-	-	-	49,873,486	67,122,974
Asian Clearing Union	1.2800	90,868,160	90,868,160	-	-	-	-
RBI SWAP		-	-	-	-	-	-
Total Interest Sensitive Foreign Currency Financial Liabilities		207,864,620	90,868,160	-	-	49,873,486	67,122,974
Non Interest Sensitive Foreign Currency Financial Liabilities							
Banks and Financial Institutions		8,683,033	8,683,033	-	-	-	-
Derivative Financial Instruments		4,648,449	1,048,241	2,355,626	448,134	796,448	-
IMF		201,668,872	-	-	-	-	201,668,872
Commercial Banks' Capital in Foreign Currency		1,193,019	-	-	-	-	1,193,019
Other Foreign Liabilities		62,902,870	62,902,870	-	-	-	-
Total non Interest Sensitive Foreign Currency Financial Liabilities		279,096,243	72,634,144	2,355,626	448,134	796,448	202,861,891
Total Foreign Currency Financial Liabilities		486,960,863	163,502,304	2,355,626	448,134	50,669,934	269,984,865
Foreign Currency Interest Rate Sensitivity Gap		859,275,250	467,976,766	76,479,327	118,516,346	263,425,785	(67,122,974)

	Weighted Avg. Int. Rate %	2017 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
Interest Sensitive Local Currency Financial Assets							
Sri Lanka Government Securities	8.9863	9,704,962	9,704,962	-	-	-	-
Treasury Bills and Bonds Reverse Repo	8.7500	22,375,124	22,375,124	-	-	-	-
Loans to Banks	8.0891	223,702	110,409	44,126	54,599	10,049	4,519
Other Assets - Staff Loans	3.9834	6,105,830	231,580	238,514	486,331	1,543,517	3,605,888
- Others	10.2520	6,579,629	593,501	622,037	1,142,843	1,870,103	2,351,145
Total Interest Sensitive Local Currency Financial Assets		44,989,247	33,015,576	904,676	1,683,773	3,423,669	5,961,551
Non Interest Sensitive Local Currency Financial Assets							
Provisional Advances to Government		199,800,871	199,800,871	-	-	-	-
Other Assets - Others		197,011	197,011	-	-	-	-
Investment in Equity Securities - Available for Sale		41,095	-	-	-	-	41,095
Total Non Interest Sensitive Local Currency Financial Assets		200,038,977	199,997,882	-	-	-	41,095
Total Local Currency Financial Assets		245,028,224	233,013,459	904,676	1,683,773	3,423,669	6,002,646
Interest Sensitive Local Currency Financial Liabilities							
Securities sold under Repurchase Agreements	7.2500	6,503,884	6,503,884	-	-	-	-
Standing Deposit Facility	7.2500	34,151,394	34,151,394	-	-	-	-
Total Interest Sensitive Local Currency Financial Liabilities		40,655,278	40,655,278	-	-	-	-
Non Interest Sensitive Local Currency Financial Liabilities							
Deposits of Banks and Financial Institutions		341,712,198	341,712,198	-	-	-	-
Deposits of Government and Governmental Entities		324,516	324,516	-	-	-	-
Balances of Employee Benefit Plans		4,547	4,547	-	-	-	-
Currency in Circulation		598,053,901	598,053,901	-	-	-	-
Other Payables		8,887,156	8,887,156	-	-	-	-
Total Non Interest Sensitive Local Currency Financial Liabilities		948,982,318	948,982,318	-	-	-	-
Total Local Currency Financial Liabilities		989,637,596	989,637,596	-	-	-	-
Local Currency Interest Rate Sensitivity Gap		4,333,968	(7,639,702)	904,676	1,683,773	3,423,669	5,961,551

Comparative figures as at 31 December 2016 were as follows:

Foreign Currency Interest Rate Sensitivity Gap:	Weighted Avg. Int. Rate %	2016 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
Interest Sensitive Foreign Currency Financial Assets							
Cash & Cash equivalents	0.6352	423,783,737	423,783,737	-	-	-	-
Securities at Fair Value through Profit or Loss and Available for Sale Investments	1.1792	378,427,237	82,598,844	37,282,832	100,641,826	117,752,141	40,151,594
IMF Related assets	0.0228	9,940,219	9,940,219	-	-	-	-
Total Interest Sensitive Foreign Currency Financial Assets		812,151,193	516,322,800	37,282,832	100,641,826	117,752,141	40,151,594
Non Interest Sensitive Foreign Currency Financial Assets							
IMF Related assets		107,068,121	-	-	-	145,906	106,922,215
Derivative Financial Instruments		198,880	198,880	-	-	-	-
Receivables		6,175,049	6,175,049	-	-	-	-
Securities at Fair Value through Profit or Loss		13,396,168	13,396,168	-	-	-	-
Total Non Interest Sensitive Foreign Currency Financial Assets		126,838,218	19,770,097	-	-	145,906	106,922,215
Total Foreign Currency Financial Assets		938,989,411	536,092,897	37,282,832	100,641,826	117,898,047	147,073,809
Interest Sensitive Foreign Currency Financial Liabilities							
IMF	0.2440	82,976,654	27,750,312	6,937,578	-	18,108,285	30,180,479
Asian Clearing Union	0.5100	79,863,615	79,863,615	-	-	-	-
RBI SWAP	2.9973	59,920,000	59,920,000	-	-	-	-
Total Interest Sensitive Foreign Currency Financial Liabilities		222,760,269	167,533,927	6,937,578	-	18,108,285	30,180,479
Non Interest Sensitive Foreign Currency Financial Liabilities							
Banks and Financial Institutions		45,566,681	45,566,681	-	-	-	-
Derivative Financial Instruments		14,573,675	5,088,148	3,564,938	3,931,574	1,989,015	-
IMF		186,563,942	-	-	-	-	186,563,942
Commercial Banks' Capital in Foreign Currency		1,169,177	-	-	-	-	1,169,177
Other Foreign Liabilities		35,160,855	35,160,855	-	-	-	-
Total Non Interest Sensitive Foreign Currency Financial Liabilities		283,034,330	85,815,684	3,564,938	3,931,574	1,989,015	187,733,119
Total Foreign Currency Financial Liabilities		505,794,599	253,349,611	10,502,516	3,931,574	20,097,300	217,913,598
Foreign Currency Interest Rate Sensitivity Gap		589,390,924	348,788,873	30,345,254	100,641,826	99,643,856	9,971,115

	Weighted Avg. Int. Rate %	2016 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
Interest Sensitive Local Currency Financial Assets							
Sri Lanka Government Securities	9.1639	320,605,082	233,255,698	87,349,384	-	-	-
Treasury Bills and Bonds Reverse Repo	8.5000	30,820,231	30,820,231	-	-	-	-
Loans to Banks	8.4016	484,043	182,396	107,091	125,390	61,511	7,655
Other Assets - Staff Loans	3.5355	5,603,510	92,230	92,417	192,376	621,059	4,605,428
- Others	10.0079	5,252,364	661,399	183,437	843,138	2,134,946	1,429,444
Total Interest Sensitive Local Currency Financial Assets		362,765,230	265,011,953	87,732,329	1,160,904	2,817,516	6,042,528
Non Interest Sensitive Local Currency Financial Assets							
Provisional Advances to Government		83,306,771	83,306,771	-	-	-	-
Other Assets - Others		1,638,273	1,638,273	-	-	-	-
Investment in Equity Securities - Available for Sale		41,095	-	-	-	-	41,095
Total Non Interest Sensitive Local Currency Financial Assets		84,986,139	84,945,044	-	-	-	41,095
Total Local Currency Financial Assets		447,751,369	349,956,998	87,732,329	1,160,904	2,817,516	6,083,622
Interest Sensitive Local Currency Financial Liabilities							
Securities sold under Repurchase Agreements	7.4282	21,383,724	21,383,724	-	-	-	-
Standing Deposit Facility	7.0000	48,670,712	48,670,712	-	-	-	-
Total Interest Sensitive Local Currency Financial Liabilities		70,054,436	70,054,436	-	-	-	-
Non Interest Sensitive Local Currency Financial Liabilities							
Deposits of Banks and Financial Institutions		303,251,290	303,251,290	-	-	-	-
Deposits of Government and Governmental Entities		450,884	450,884	-	-	-	-
Balances of Employee Benefit Plans		51,744	51,744	-	-	-	-
Currency in Circulation		552,777,865	552,777,865	-	-	-	-
Other Payables		8,563,548	8,563,548	-	-	-	-
Total Non Interest Sensitive Local Currency Financial Liabilities		865,095,331	865,095,331	-	-	-	-
Total Local Currency Financial Liabilities		935,149,767	935,149,767	-	-	-	-
Local Currency Interest Rate Sensitivity Gap		292,710,794	194,957,517	87,732,329	1,160,904	2,817,516	6,042,528

45.3 Foreign Currency Risk

Foreign currency activities result mainly from the Bank's holding of foreign currency assets under its foreign reserve 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.

Net Exposure to Foreign Currencies

As at 31 December 2017, the Central Bank of Sri Lanka's net exposure to major currencies were as follows:

As at 31 December 2017	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	Australian Dollars Rs. 000	Canadian Dollars Rs. 000	New Zealand Dollars Rs. 000	Other Currencies Rs. 000	
Foreign Currency Financial Assets										
Cash & Cash Equivalents	133,266,127	(50,974,866)	(58,292,654)	92,771,973	-	124,864,455	390,378	(6,412,537)	224,214,765	459,827,641
Securities at Fair Value through Profit or Loss and Available for Sale	532,783,747	3,676,937	6,297,818	5,302,523	-	34,445,694	-	11,011,941	17,974,651	611,493,311
Investments										
Derivative Financial Instruments	536	-	-	-	-	-	-	-	4,939,919	4,940,455
IMF Related Assets	-	-	-	-	126,838,152	-	-	-	-	126,838,152
Other Receivables	3,665,700	-	-	-	4,794	-	-	-	-	3,670,494
Total Foreign Currency Financial Assets	669,716,110	(47,297,929)	(51,994,836)	98,074,496	126,842,946	159,310,149	390,378	4,599,404	247,129,335	1,206,770,053
Proportion	55.50%	-3.92%	-4.31%	8.13%	10.51%	13.20%	0.03%	0.38%	20.48%	100%
Foreign Currency Financial Liabilities										
Banks and Financial Institutions	8,681,097	12	-	-	-	-	-	-	1,924	8,683,033
Derivative Financial Instruments	-	-	-	-	-	-	-	-	4,648,449	4,648,449
Asian Clearing Union	90,868,160	-	-	-	-	-	-	-	-	90,868,160
IMF	-	-	-	-	318,665,332	-	-	-	-	318,665,332
Other	19,241,566	-	-	-	-	-	-	-	44,854,323	64,095,889
Total Foreign Currency Financial Liabilities	118,790,823	12	-	-	318,665,332	-	-	-	49,504,696	486,960,863
Proportion	24.39%	0.00%	0.00%	0.00%	65.44%	0.00%	0.00%	0.00%	10.17%	100%
Net Foreign Currency Exposure	550,925,287	(47,297,941)	(51,994,836)	98,074,496	(191,822,386)	159,310,149	390,378	4,599,404	197,624,639	719,809,190

Cash and Cash Equivalents include the foreign transactions entered into for buying and selling of various currencies of 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 2017	Sri Lanka Rupees Rs. 000	United States Dollars Rs. 000	Euro Rs. 000	Sterling Pound Rs. 000	Japanese Yen Rs. 000	Australian Dollars Rs. 000	Swedish Krona Rs. 000
Purchases	260,379,629	(18,113,664)	131,788	(62,622)	(4,876)	(6,352,618)	-
Sales	(24,459,676)	(231,780,079)	5,375,438	19,321,868	4,876	30,444	-
FX Forward Contra Account - Near Leg	(1,667)	-	-	-	-	-	-
Forward contra account	(4,468,841)	-	-	-	-	-	-

As at 31 December 2016, the Central Bank of Sri Lanka's net exposure to major currencies were as follows:

As at 31 December 2016	Currency									
	United States Dollars Rs. 000	Euro Rs. 000	Japanese Yen Rs. 000	Sterling Pound Rs. 000	SDR Rs. 000	Australian Dollars Rs. 000	Canadian Dollars Rs. 000	New Zealand Dollars Rs. 000	Other Currencies Rs. 000	Total All Currencies Rs. 000
Foreign Currency Financial Assets										
Cash & Cash Equivalents	60,672,511	(52,620,544)	(44,196,304)	92,331,449	-	134,790,117	(9,651,058)	(5,876,338)	248,333,904	423,783,737
Securities at Fair Value through Profit or Loss and Available for Sale	243,152,847	44,267,349	21,813,382	11,527,275	-	21,471,379	9,797,465	9,687,691	30,106,017	391,823,404
Investments	-	-	-	-	-	-	-	-	198,880	198,880
Derivative Financial Instruments	-	-	-	-	-	-	-	-	-	-
IMF Related Assets	-	-	-	-	117,008,340	-	-	-	-	117,008,340
Other Receivables	6,053,745	120,772	-	-	532	-	-	-	-	6,175,049
Total Foreign Currency Financial Assets	309,879,103	(8,232,423)	(22,382,922)	103,858,723	117,008,872	156,261,496	146,407	3,811,353	278,638,802	938,989,411
Proportion	33.00%	-0.88%	-2.38%	11.06%	12.46%	16.64%	0.02%	0.41%	29.67%	100%
Foreign Currency Financial Liabilities										
Banks and Financial Institutions	45,566,531	10	-	139	-	-	1	-	-	45,566,681
Derivative Financial Instruments	11	-	-	-	-	-	-	-	14,573,664	14,573,675
Asian Clearing Union	79,863,615	-	-	-	-	-	-	-	-	79,863,615
IMF	-	-	-	-	269,540,596	-	-	-	-	269,540,596
Other	95,804,614	-	-	-	-	-	-	-	445,418	96,250,032
Total Foreign Currency Financial Liabilities	221,234,771	10	-	139	269,540,596	-	1	-	15,019,082	505,794,599
Proportion	43.74%	0.00%	0.00%	0.00%	53.29%	0.00%	0.00%	0.00%	4.27%	100%
Net Foreign Currency Exposure	88,644,332	(8,232,433)	(22,382,922)	103,858,584	(152,531,724)	156,261,496	146,406	3,811,353	263,619,720	433,194,812

Cash and Cash Equivalents include the foreign transactions entered into for buying and selling of various currencies of 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 2016	Sri Lanka Rupees Rs. 000	United States Dollars Rs. 000	Euro Rs. 000	Sterling Pound Rs. 000	Japanese Yen Rs. 000	Australian Dollars Rs. 000	Swedish Krona Rs. 000
Purchases	399,872,823	(15,716,215)	(985)	(62,622)	(4,876)	(6,352,618)	-
Sales	(26,858,576)	(377,765,524)	5,375,438	19,321,868	4,876	30,444	(960)
FX Forward Contra Account - Near Leg	(1,667)	-	-	-	-	-	-
Forward contra account	2,158,595	-	-	-	-	-	-

45.4 Contractual maturities of un-discounted cash flows of Financial Assets and Liabilities

As at 31 December 2017, Contractual maturities of un-discounted cash flows of Financial Assets and Liabilities are as follows,

As at 31 December 2017	Less than 6 months	6 Months -1 Yr	1-2 Yrs	2-5 Yrs	Over 5 Yrs	Total
	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000
Foreign Currency Financial Assets						
Cash & Cash Equivalents	459,827,641	-	-	-	-	459,827,641
Securities at Fair Value through Profit or Loss	21,369,496	4,465,690	13,178,459	8,851,636	-	47,865,281
Available for Sale Investments	46,372,253	94,705,246	126,493,457	322,848,221	-	590,419,177
IMF Related Assets	11,094,542	-	-	164,565	115,579,046	126,838,153
Other Receivables	3,670,494	-	-	-	-	3,670,494
Total un-discounted Foreign Financial Assets	542,334,426	99,170,936	139,671,916	331,864,422	115,579,046	1,228,620,746
Local Currency Financial Assets						
Sri Lanka Government Securities	32,288,005	-	-	-	-	32,288,005
Provisional Advances to Government	199,800,871	-	-	-	-	199,800,871
Loans to Banks	114,827	46,409	56,593	11,274	4,697	233,800
Equity Investments in Financial and Other Institutions	-	-	-	-	41,095	41,095
Other Assets	14,901,062	1,189,827	2,713,417	4,296,510	8,129,740	31,230,555
Total un-discounted Local Financial Assets	247,104,765	1,236,235	2,770,010	4,307,784	8,175,531	263,594,325
Total un-discounted Financial Assets	789,439,191	100,407,171	142,441,927	336,172,205	123,754,577	1,492,215,071
Foreign Financial Liabilities						
Banks and Financial Institutions	9,607,147	1,348,974	2,678,505	7,689,134	10,313,402	31,637,162
Asian Clearing Union	90,868,160	-	-	-	-	90,868,160
IMF	-	-	-	30,374,077	288,291,256	318,665,333
Other	62,902,870	-	-	-	1,193,019	64,095,889
Total un-discounted Foreign Financial Liabilities	163,378,177	1,348,974	2,678,505	38,063,211	299,797,677	505,266,544
Local Currency Financial Liabilities						
Deposits of Banks and Financial Institutions	341,712,198	-	-	-	-	341,712,198
Deposits of Government and Governmental Entities	324,517	-	-	-	-	324,517
Securities Sold Under Repurchase Agreements	40,663	-	-	-	-	40,663
Balances of Employee Benefit Plans	4,547	-	-	-	-	4,547
Currency in Circulation	598,053,901	-	-	-	-	598,053,901
Other Payables	9,189,166	-	-	-	-	9,189,166
Total un-discounted Local Financial Liabilities	949,324,992	-	-	-	-	949,324,992
Total un-discounted Financial Liabilities	1,112,703,169	1,348,974	2,678,505	38,063,211	299,797,677	1,454,591,536
Net un-discounted Financial Assets/ (Liabilities)	(323,263,978)	99,058,197	139,763,422	298,108,994	(176,043,100)	37,623,535

As at 31 December 2017	Less than 6 months	6 Months -1 Yr
	Rs. 000	Rs. 000
Derivative Financial Assets	178,883,331	57,169,395
Derivative Financial Liabilities	171,988,417	56,697,667

Foreign Currency Conversions

All future cash flows related to Foreign Currency Financial Assets & Liabilities are converted to reporting currency using the rate of exchange prevailing at the reporting date.

As at 31 December 2016, Contractual maturities of un-discounted cash flows of Financial Assets and Liabilities are as follows,

As at 31 December 2016	Less than 6 months	6 Months -1 Yr	1-2 Yrs	2-5 Yrs	Over 5 Yrs	Total
	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000
Foreign Currency Financial Assets						
Cash & Cash Equivalents	423,783,737	-	-	-	-	423,783,737
Securities at Fair Value through Profit or Loss	18,588,564	5,033,982	12,151,636	8,087,248	-	43,861,430
Available for Sale Investments	54,001,291	39,271,443	104,459,788	120,422,348	38,708,398	356,863,268
IMF Related Assets	9,940,219	-	-	145,906	106,922,214	117,008,339
Other Receivables	6,175,049	-	-	-	-	6,175,049
Total un-discounted Foreign Financial Assets	512,488,860	44,305,425	116,611,424	128,655,502	145,630,612	947,691,823
Local Currency Financial Assets						
Sri Lanka Government Securities	267,791,962	94,425,980	-	-	-	362,217,942
Provisional Advances to Government	83,306,771	-	-	-	-	83,306,771
Loans to Banks	194,137	114,307	132,090	64,456	8,108	513,098
Equity Investments in Financial and Other Institutions	-	-	-	-	41,095	41,095
Other Assets	16,371,699	645,307	1,684,900	4,588,533	6,697,731	24,592,998
Total un-discounted Local Financial Assets	367,664,569	95,185,594	1,816,990	4,652,989	6,746,934	470,671,904
Total un-discounted Financial Assets	880,153,429	139,491,019	118,428,414	133,308,491	152,377,546	1,418,363,727
Foreign Financial Liabilities						
Banks and Financial Institutions	44,456,357	418,671	793,905	2,337,833	3,461,514	51,468,280
Asian Clearing Union	79,863,615	-	-	-	-	79,863,615
IMF	27,750,312	6,937,578	-	10,060,159	224,792,547	269,540,596
Other	95,125,637	-	-	-	1,124,395	96,250,032
Total un-discounted Foreign Financial Liabilities	247,195,921	7,356,249	793,905	12,397,992	229,378,456	497,122,523
Local Currency Financial Liabilities						
Deposits of Banks and Financial Institutions	303,251,290	-	-	-	-	303,251,290
Deposits of Government and Governmental Entities	450,884	-	-	-	-	450,884
Securities Sold Under Repurchase Agreements	70,081,240	-	-	-	-	70,081,240
Balances of Employee Benefit Plans	51,744	-	-	-	-	51,744
Currency in Circulation	552,777,865	-	-	-	-	552,777,865
Other Payables	8,563,548	-	-	-	-	8,563,548
Total un-discounted Local Financial Liabilities	935,176,571	-	-	-	-	935,176,571
Total un-discounted Financial Liabilities	1,182,372,492	7,356,249	793,905	12,397,992	229,378,456	1,432,299,094
Net un-discounted Financial Assets/ (Liabilities)	(302,219,063)	132,134,770	117,634,509	120,910,499	(77,000,910)	(13,935,367)
As at 31 December 2016						
	Less than 6 months Rs. 000	6 Months -1 Yr Rs. 000				
Derivative Financial Assets	279,092,132	93,922,515				
Derivative Financial Liabilities	279,934,575	92,340,465				

45.5 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 and 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 and USD /LKR Swaps.

46. MATURITY ANALYSIS OF ASSETS & LIABILITIES

As at 31 December 2017

	Less than 12 months	Over 12 months	Total
	Rs. 000	Rs. 000	Rs. 000
Assets			
Cash & Cash Equivalents	459,827,641	-	459,827,641
Securities at Fair Value through Profit or Loss	23,416,953	21,847,423	45,264,376
Available for Sale Investments	134,413,318	431,815,617	566,228,935
Derivative Financial Instruments	4,940,455	-	4,940,455
IMF Related Assets	11,094,542	115,743,610	126,838,152
Other Foreign Receivables	3,670,494	-	3,670,494
Sri Lanka Government Securities	32,080,086	-	32,080,086
Provisional Advances to Government	199,800,871	-	199,800,871
Loans to Banks	154,536	69,166	223,702
Equity Investments in Financial and Other Institutions	-	41,095	41,095
Other Assets	2,180,722	10,701,748	12,882,470
Gold	-	126,583,727	126,583,727
Inventories	-	6,875,533	6,875,533
Other Receivables and Prepayments	1,369,157	165,691	1,534,848
Property, Plant and Equipment	-	17,960,517	17,960,517
Intangible Assets	-	80,623	80,623
Total Assets	872,948,775	731,884,750	1,604,833,525
Liabilities			
Banks and Financial Institutions	8,683,033	-	8,683,033
Derivative Financial Instruments	4,648,449	-	4,648,449
Asian Clearing Union	90,868,160	-	90,868,160
IMF	-	318,665,332	318,665,332
Other	62,902,870	1,193,019	64,095,889
Deposits by Banks and Financial Institutions	341,712,198	-	341,712,198
Balances with Government and Governmental Entities	324,517	-	324,517
Securities Sold Under Agreement to Repurchase	40,655,278	-	40,655,278
Balances with Employee Benefit Plans	4,547	-	4,547
Currency in Circulation	598,053,901	-	598,053,901
Other Payables	8,887,156	-	8,887,156
Deferred Grants	34	11	45
Pension and Other Post Employment Benefit Plans	-	671,061	671,061
Miscellaneous Liabilities and Accruals	160,398	51,322	211,720
Total Liabilities	1,156,900,541	320,580,745	1,477,481,286
Net	(283,951,766)	411,304,005	127,352,239

As at 31 December 2016	Less than 12 months	Over 12 months	Total
Assets	Rs. 000	Rs. 000	Rs. 000
Cash & Cash Equivalents	423,783,737	-	423,783,737
Securities at Fair Value through Profit or Loss	9,948,121	33,330,634	43,278,755
Available for Sale Investments	88,536,415	260,008,235	348,544,650
Derivative Financial Instruments	198,880	-	198,880
IMF Related Assets	9,940,219	107,068,121	117,008,340
Other Foreign Receivables	6,175,049	-	6,175,049
Sri Lanka Government Securities	351,426,470	-	351,426,470
Provisional Advances to Government	83,306,771	-	83,306,771
Loans to Banks	289,487	194,556	484,043
Equity Investments in Financial and Other Institutions	-	41,095	41,095
Other Assets	2,952,281	9,540,709	12,492,990
Gold	-	111,009,339	111,009,339
Inventories	-	6,114,861	6,114,861
Other Receivables and Prepayments	6,659,993	396,414	7,056,407
Property, Plant and Equipment	-	18,132,390	18,132,390
Intangible Assets	-	156,320	156,320
Total Assets	<u>983,217,423</u>	<u>545,992,674</u>	<u>1,529,210,097</u>
Liabilities			
Banks and Financial Institutions	45,566,681	-	45,566,681
Derivative Financial Instruments	14,573,675	-	14,573,675
Asian Clearing Union	79,863,615	-	79,863,615
IMF	34,687,890	234,852,706	269,540,596
Other	95,125,637	1,124,395	96,250,032
Deposits by Banks and Financial Institutions	303,251,290	-	303,251,290
Balances with Government and Governmental Entities	450,884	-	450,884
Securities Sold Under Agreement to Repurchase	70,054,436	-	70,054,436
Balances with Employee Benefit Plans	51,744	-	51,744
Currency in Circulation	552,777,865	-	552,777,865
Other Payables	8,563,548	-	8,563,548
Deferred Grants	34	46	80
Pension and Other Post Employment Benefit Plans	-	2,429,153	2,429,153
Miscellaneous Liabilities and Accruals	182,544	10,753	193,297
Total Liabilities	<u>1,205,149,843</u>	<u>238,417,053</u>	<u>1,443,566,896</u>
Net	<u>(221,932,420)</u>	<u>307,575,621</u>	<u>85,643,201</u>

47. FAIR VALUE DISCLOSURES

47.1 Fair Value of Assets and Liabilities

The fair value of assets and liabilities 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 assets and liabilities by valuation technique :

Level 1: Quoted (un-adjusted) 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 are not based on observable market data;

The following table shows an analysis of assets and liabilities recorded at fair value hierarchy:

31 December 2017	Level 1 Rs. 000	Level 2 Rs. 000	Level 3 Rs. 000	Total Rs. 000
Financial Assets				
Securities at Fair Value through Profit or Loss	45,264,376	-	-	45,264,376
Available for Sale Investments	566,228,935	-	-	566,228,935
Derivatives	-	4,940,455	-	4,940,455
	<u>611,493,311</u>	<u>4,940,455</u>	<u>-</u>	<u>616,433,766</u>
Foreign Currency Non-Financial Assets				
Gold	126,583,727	-	-	126,583,727
	<u>126,583,727</u>	<u>-</u>	<u>-</u>	<u>126,583,727</u>
Local Currency Financial Assets				
Sri Lanka Government Securities	9,754,483	-	-	9,754,483
	<u>9,754,483</u>	<u>-</u>	<u>-</u>	<u>9,754,483</u>
Other Non-Financial Assets				
Land	-	-	8,976,339	8,976,339
Building	-	-	7,515,327	7,515,327
	<u>-</u>	<u>-</u>	<u>16,491,666</u>	<u>16,491,666</u>
Financial Liabilities				
Embedded Derivatives - Currency Options	-	-	1,244,581	1,244,581
Derivatives	-	3,403,868	-	3,403,868
	<u>-</u>	<u>3,403,868</u>	<u>1,244,581</u>	<u>4,648,449</u>
31 December 2016	Level 1 Rs. 000	Level 2 Rs. 000	Level 3 Rs. 000	Total Rs. 000
Financial Assets				
Securities at Fair Value through Profit or Loss	43,278,755	-	-	43,278,755
Available for Sale Investments	348,544,650	-	-	348,544,650
Derivatives	-	198,880	-	198,880
	<u>391,823,405</u>	<u>198,880</u>	<u>-</u>	<u>392,022,285</u>
Foreign Currency Non-Financial Assets				
Gold	111,009,339	-	-	111,009,339
	<u>111,009,339</u>	<u>-</u>	<u>-</u>	<u>111,009,339</u>
Local Currency Financial Assets				
Sri Lanka Government Securities	321,779,576	-	-	321,779,576
	<u>321,779,576</u>	<u>-</u>	<u>-</u>	<u>321,779,576</u>
Other Non-Financial Assets				
Land	-	-	8,976,339	8,976,339
Building	-	-	7,695,682	7,695,682
	<u>-</u>	<u>-</u>	<u>16,672,021</u>	<u>16,672,021</u>
Financial Liabilities				
Embedded Derivatives - Currency Options	-	-	5,911,812	5,911,812
Derivatives	-	8,661,863	-	8,661,863
	<u>-</u>	<u>8,661,863</u>	<u>5,911,812</u>	<u>14,573,675</u>

Land & Buildings

Valuation Method

Land is valued using market approach with direct comparison method, whereby assets are compared to recent sales with no added or nominal added improvement value, making adjustments for points of difference to derive the fair value.

Depreciated Current Replacement Cost (DRC) method is used in valuing all the buildings except Central Point, White Aways and Lloyds Building, considering that the assets controlled by the public sector entities that provide service to the community are not traded on an open liquid market.

Income approach is used to value the other buildings which values the property based on estimated future income, profits or cash flow that are converted (discounted) to a single current amount.

Under the Market Approach, estimated fair value would get increased/(decreased) if;

Price per perch would get higher/(lower)

Price per square foot would get higher/(lower)

Depreciation rate for building would get lower/(higher)

Under Income Approach, estimated fair value would get increased/(decreased) if;

Gross annual rentals would get higher/(lower)

Years purchase would get higher/(lower)

Derivatives

Derivative valuation models use forward prices (calculated by extrapolating the forward points available in the market) and discount rates calculated based on zero coupon yield curves of the respective currencies as of the valuation date. If the instrument that is valued contains a margin, adjustments are made to the forward prices and/or the interest rates to represent the impact of the margin rate.

Embedded Derivatives - Currency Options

Fair Value of the Embedded Derivative Products was calculated using Black- Scholes model

	Level 3			
	2017 Rs.000		2016 Rs.000	
Balance as at 1 January	5,911,813		10,290,162	
Derivative Liabilities	(4,667,231)		(4,378,349)	
Balance as at 31 December	<u>1,244,582</u>		<u>5,911,813</u>	
Total unrealised gains included in earnings	4,667,231		4,378,349	
Significant unobservable inputs used				
Discount Rate	10%			
Volatility	4%			
Sensitivity Analysis				
	Discount Rate		Volatility	
	9%	11%	3%	5%
	Rs.000	Rs.000	Rs.000	Rs.000
Embedded Derivatives - Currency Options	1,271,115	1,218,952	1,244,547	1,245,000
Deferred Asset on Embedded Derivatives	2017 Rs.000		2016 Rs.000	
Balance as at 1 January	4,625,665		13,292,126	
Premium Amortised during the year	(4,256,210)		(8,666,461)	
Balance as at 31 December	<u>369,455</u>		<u>4,625,665</u>	

47.2 Repurchase and Reverse-Repurchase Agreements

The reported value of repurchase and reverse-repurchase agreements is considered to approximate their fair value due to short term nature of the agreements. The carrying value of Sri Lanka Government Securities sold under agreements to repurchase as at 31 December 2017 was Rs. 6,503.88 Mn (2016 – Rs. 21,383.72 Mn) and provided Standing Deposit Facility of Rs. 34,151.39 Mn (2016 – Rs 48,670.71 Mn). The carrying value of Sri Lanka Government Securities purchased under agreements to resell as at 31 December 2017 was Rs. 22,375.12 Mn (2016 – Rs. 30,821.39 Mn).

47.3 Currency in Circulation

The fair value of Currency in Circulation is considered to be its face value as reported in the Financial Statements.

47.4 Deposits

The carrying value of deposits are considered to approximate their fair value as they are payable on demand.

47.5 Determination of Fair Value and Fair Value Hierarchy

Set out below is a comparison, by class, of the carrying value and fair value of Bank's financial assets and liabilities other than those with carrying values that are reasonable approximation of fair value.

	Carrying Amount		Fair Value	
	2017 Rs. 000	2016 Rs. 000	2017 Rs. 000	2016 Rs. 000
Foreign Currency Financial Assets				
Foreign Currency Trading/ Available for Sale Securities	611,493,311	391,823,405	611,493,311	391,823,405
Derivative Financial Instruments	4,940,455	198,880	4,940,455	198,880
Local Currency Financial Assets				
Sri Lanka Government Securities	32,080,086	351,426,470	32,129,607	352,586,576
Loans to Banks	223,702	484,043	214,077	460,376
Other Assets	12,882,470	12,492,990	9,702,999	9,743,612
Foreign Currency Non Financial Assets				
Allocated Gold	126,583,727	111,009,339	126,583,727	111,009,339
Foreign Currency Financial Liabilities				
Derivative Financial Instruments	4,648,449	14,573,675	4,648,449	14,573,675

48. COMPARATIVE INFORMATION

	2017 Rs. 000	2016 Rs. 000
As reported previously:		
Local Currency Financial Assets		
Other Assets		12,322,596
Non-Financial Assets		
Other Receivables and Prepayments		7,226,801
Current Presentation:		
Local Currency Financial Assets		
Other Assets	12,882,470	12,492,990
Non-Financial Assets		
Other Receivables and Prepayments	1,534,848	7,056,407

Interest receivable on Investment of Internal Funds amounting to Rs.170.39 Mn which was classified under Other Receivables and Prepayments in 2016 has now been included with respective investment classifications for better presentation.

49. RELATED PARTIES**49.1 Transactions with State and State Controlled Entities**

In the normal course of its operations, the Bank enters into transactions with related parties. Related parties include the Government of Sri Lanka (State as the ultimate owner of the CBSL), various government departments and State controlled entities. Particulars of transactions and arrangements entered into by the Bank with the State and State controlled entities which are individually significant and for other transactions that are collectively, but not individually, significant as per IAS 24 -Amended Related Party Disclosures are as follows:

Nature of the Transaction	2017 Rs 000	2016 Rs 000
Transactions:		
Outright purchases of Government Securities	-	8,065,953
Outright sales of Government Securities	74,237,317	37,375,643
CBSL and Government Securities Purchased/Sold under Agreement to Repurchase/Sales	4,311,989,631	6,215,152,910
Interest income/expenses on CBSL and Government Securities Purchased/Sold under Agreement to Repurchase/Sales	1,210,183	1,885,223
Funds received on behalf of Government (Note 21.1 - 21.9)	44,676,985	6,079,600
Funds disbursed on behalf of Government (Note 21.1 - 21.9)	17,346,423	31,001,635
Cost of Printing currency notes, for the year ended 31 December (Note 49.1.3)	1,906,625	3,162,625
Payments for Goods, Services and Taxes, during the year ended 31 December (Note 49.1.4)	2,744,815	3,063,380
Paid Surplus to Government, during the period (Note 32)	-	5,000,000
Gross Foreign Exchange Transactions during the period (Note 49.1.6)		
Sales	5,337,500	55,884,998
Purchases	85,719,851	68,112,483
USD/LKR Derivatives	751,569,889	737,197,729
Funds Received in respect of Abandoned Property, during the year	123,394	275,236
Consultancy, Communication, Advisory and Professional Fees (Note 49.1.7)	-	28,038
Rent Income	412,206	387,569
Other Transactions (Note 49.1.11)	996,174	966,694
Balances:		
Sri Lanka Government Securities Held by CBSL (Note 49.1.8)	9,704,962	320,605,082
Provisional Advances to Government (Note 10)	199,800,871	83,306,771
Loans given under Susahana Phase I and II, Provincial Development Credit Scheme, Saubaghya Loan Scheme, Awakening North Loan Scheme (phase II), Resumption of Economic Activities in the East (phase II) and Repair of Damaged Houses in North and East	28,254	112,652
Government Securities held for specific purposes	6,443,984	5,208,837
RTGS Balances with Banks and Financial Institutions (Note 22)	215,901,806	183,836,224
Nostro Balance with BOC London	185,324	168,790
Receivable from Treasury and other Ministries	54,490	1,401,497
Payable to Treasury and other Ministries (Note 21)	62,576,551	32,513,907
Current Account Balances with Government and Governmental Entities as at 31 December	84,833	198,936
Abandoned Property balances	2,257,579	1,952,446
Other Balances (Note 49.1.11)	599,623	700,951

49.1.1 Empowered by the sections 28-33 of the MLA the Bank Supervision Department of the Bank carries out regulatory and supervisory functions of the banks licensed by the Monetary Board of CBSL. As at 31 December 2017, 03 Licensed Commercial Banks and 04 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 the Bank carries out its regulatory and supervisory functions in respect of Non-Bank Financial Institutions. Accordingly, related entities of state controlled or government funded Non-bank Financial Institutions are under the supervision of this department.

49.1.2 As per Section 113 of the MLA, the Monetary Board and the Bank are vested with the function of public debt management. Accordingly, as the agent of the government, Public Debt Department (PDD) of the bank 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.

49.1.3 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 the Bank 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.

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

49.1.5 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 51.

49.1.6 In accordance with the provisions of the MLA, 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 Lankan Rupee. The amounts of purchases and sales of foreign exchange represents results of such monitoring activities.

49.1.7 This amount represents the payments made by the Bank for consultancy and professional fees on United Nations human rights investigations. These payments were recorded under administration expenses.

49.1.8 The Domestic Operations Department of the Bank performs its direct functions of implementing the Bank's monetary policy mainly through open market operations as per sections 90-92 of the MLA No 58 of 1949 (amended) and enforcing Statutory Reserve Requirement as per 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 2017 are given in Note 23 and 24. Interest earned on the government securities is given in Note 33.

49.1.9 The Bank also has custodial arrangements with one State-controlled bank, for which no charges were levied.

49.1.10 As per the circular issued by Director of 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. As at 31 December 2017, Rs. 6.83 Mn loans were outstanding under the refinance scheme, from People's Bank - Rs. 2.46 Mn (2016 - Rs.25.57 Mn), Bank of Ceylon - Rs. 1.88 Mn (2016 - Rs. 7.71 Mn), Pradeshiya

Sanwardana Bank - Rs. 0.63 Mn (2016 - Rs.23.42 Mn) and Lankaputhra Development Bank Rs.1.86 Mn (2016 - Rs.7.78 Mn) and for which RDD has received an interest of Rs. 99.19 Mn.

49.1.11 Other Balances and transactions include the transactions carried out with the government, government departments and state controlled entities that are not individually significant.

49.2 Transactions with Key Managerial Personnel

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

49.3 Compensations to the Key Managerial Personnel

	2017 Rs 000	2016 Rs 000
Short Term Employee Benefits	123,072	123,948

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

49.4 Other Transactions with Key Managerial Personnel

	2017 Rs 000	2016 Rs 000
Loans to Key Managerial Personnel	73,141	57,793

All the loans are adequately secured and carry interest rates ranging from 2%-7% depending on the loan category and are repayable monthly.

49.5 Transactions with Post-Employment Benefit Plans

	2017 Rs 000	2016 Rs 000
Contributions paid and payable	69,573	69,511

The Bank contributed various amounts to Pension and Other Post Retirement Plans as disclosed in Note 29 and paid Rs. 542.58 Mn (2016 - Rs. 559.67 Mn) 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 25.

50. CONTINGENT LIABILITIES AND COMMITMENTS

50.1 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 Bank by the General Treasury. There were no such outstanding guarantees as at 31 December 2017.

50.2 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 of 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 arrangement are given below.

Local commercial banks - in respect of credit guarantees.

	Currency of Guarantee	Outstanding Guarantee Amount	
		2017 Rs. 000	2016 Rs. 000
Related Parties	Rupees	1,798	54,799
Others	Rupees	-	5,311
Total Credit Guarantees		1,798	60,110

50.3 Fiduciary Activities

The Bank carries out fiduciary activities under the provisions of the MLA. 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.

50.4 Legal Claims

The Bank is a defendant in a case where legal action instituted by stakeholders of the entity involved, claiming Rs.35 Mn. This case is contested by the Bank and no provision has been made in the financial statements.

The Bank is a plaintiff in 02 cases claiming Rs. 16.57 Mn for the damages and no provisions for such fines have been made in the financial statements.

Further, there were a number of legal proceedings outstanding against the Bank as at 31 December 2017 and no provision has been made as the Bank is of the opinion that it is unlikely that any significant loss will arise.

50.5 Commitments

a) As at 31 December 2017, the Bank has capital commitments amounting to Rs. 277.26 Mn (2016 – Rs. 148.30 Mn), in respect of the acquisition of Property, Plant and Equipment.

b) As at 31 December 2017, outstanding forward exchange transactions are as follows:

Forward exchange contracts		2017 Rs 000	2016 Rs 000
Forward Exchange Sales			
USD		1,850,735	2,501,145
EUR		2	-
SEK		-	58
Forward Exchange Purchases			
USD		5,000	15,998
EUR		400	-

50.6 Assets Pledged

In order to facilitate the securities settlement process, securities amounting to AUD 35.0 Mn (2016 - AUD 35.0 Mn) with Carrying value of AUD 35.74 Mn (2016 - AUD 36.02 Mn) were pledged by the Bank to Euro Clear and obtained a credit facility of USD 30.0 Mn (2016 – USD 30.0 Mn). The pledged securities are held in a separate account at Euro Clear.

These securities are presented in the 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.

With the view of facilitating the Repurchase agreements (Repo transactions) as a part of the Open Market Operations in order to maintain the short term interest rate by regulating the liquidity in the money market, Rs. 6,500 Mn – carrying value Rs. 6,469 Mn (as at 31/12/2016 – Rs. 21,375 Mn – carrying value Rs. 21,350 Mn) were pledged by the Bank to the various Primary Dealers as at 31 December 2017.

These securities are presented in the statement of financial position as “Sri Lanka Government Securities”. The Bank

conducts these transactions in accordance with the requirements of the Monetary Law Act No. 58 of 1949.

51. TRUST AND CUSTODIAL ACTIVITIES

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 the GOSL, trusts, retirement benefit plans and other institutions. The significant trust activities performed by the Bank are as follows:

- 51.1** The bank handles disbursements and repayments of various foreign loans and grants under foreign funded development projects and credit schemes on behalf of the GOSL. It also collects counterparty funds under various foreign loans and grants on behalf of the GOSL and invests such funds in treasury bills on requests made by donor agencies.
- 51.2** The 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.
- 51.3** The bank administered the Deposit Insurance Scheme, which was a voluntary deposit insurance scheme opened 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 and with effect from 01st October 2010 funds of this scheme have been transferred to the Sri Lanka Deposit Insurance scheme which was formed as per gazette No:1673/11 dated 28 September 2010.
- 51.4** As per the Gazette No:1673/11 dated 28 September 2010, the Bank has established a Mandatory Deposit Insurance Scheme named Sri Lanka Deposit Insurance Scheme w. e. f. 01 October 2010 as an act of national interest to protect the funds of depositors.

All Licensed Commercial Banks (LCBs), Licensed Specialized Banks (LSBs) and Licensed Finance Companies (LFCs) shall be the members of this Scheme. Accordingly, 76 institutions are members of this Scheme. The deposits to be insured include the demand, time, savings deposit liabilities of the member institutions and value of the shares of shareholders who were initially deposit holders, whose deposits were converted into equity under the directions of the Monetary Board in 2010 and 2011 as part of the Business restructuring plans implemented prior to 01.01.2012 and exclude all borrowing instruments and specific exclusions as per section 5.2 of the said gazette notification.

The deposit insurance fund has been created with the transfer of Rs. 350.20 Mn of the investments

of Voluntary Deposit Insurance Scheme and Rs. 1,168.31 Mn of investments made out of collections of abandoned property of LCBs. As at 31 December 2017, the fund size is Rs. 45.3 Bn (provisional). Currently, the amount of compensation payable per-depositor per-institution is limited to Rs. 600,000 or its equivalent in the case of foreign currency deposits. The payment of compensation shall not be a liability of the Monetary Board or the Bank and shall be limited to funds available or raised in the deposit insurance fund including any borrowings permitted and contributions received. The Monetary Board and the Bank shall not be responsible for any liability that exceeds the total amount lying to the credit of the fund.

The Deposit Insurance Unit (DIU) established in the Resolution and Enforcement Department, is responsible for operation & management of the scheme under the instructions and supervision of the Director of Resolution and Enforcement in terms of Directions/Regulations and policies as approved by the Monetary Board from time to time and shall maintain books and accounts distinctly separate from the Financial Statements of the Bank. The Auditor General shall be the Auditor of this Scheme.

With effect from 22 November 2013, this scheme was renamed as "Sri Lanka Deposit Insurance and Liquidity Support Scheme" and the Deposit Insurance Fund was renamed as "Sri Lanka Deposit Insurance and Liquidity Support Fund".

- 51.5** The Bank carries out regulatory and supervisory functions in respect of LFCs and attends to related matters under the authority delegated to it by the Monetary Board. While carrying out such functions, with respect to failed LFCs, 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.
- 51.6** 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 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. As of 31 December 2017, all such collected funds have been refunded to banks (outstanding as at 31 December 2016 amounted to Rs. 554.26 Mn). As at 31 December 2017, Rs. 6.83 Mn was outstanding as loans under the refinance scheme (2016 - Rs. 64.48 Mn) and received an interest of Rs. 1.83 Mn for loans given. Further, Rs. 84.72 Mn (2016 - Rs. 5.69 Mn) of income was earned from the investments.

51. TRUST AND CUSTODIAL ACTIVITIES (Continued)

51.7 On behalf of the Monetary Board of the Bank, RDD acts as the exclusive agent of the 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 PFI s (Rs. Mn.)	Salient Features
Tea Development Project	USD	24.50	To increase tea smallholders' income and improve the natural environment in the project areas.	2,550.90	Collection of recoveries from Participating Financial Institutions (PFIs) as per scheduled date to be transferred to Deputy Secretary to Treasury (DST).
Second Perennial Crop Development Project	SDR	11.56	To commercialize 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 Company	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 Small and Medium Enterprises (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	
Smallholder Tea Development Project	USD	12.60	To develop smallholder tea sector and rehabilitate tea facilities.	645.93	
Poverty Alleviation Micro Finance Project	YEN	1,368.00	To set up 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 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 life of the people in the Southern Province.	564.00	
EIB Contract B	EUR	10.00	To reconstruct SMEs directly affected by Tsunami.	1,553.27	
Susahana	LKR	3,000.00	To provide credit facilities to resume Micro, Small and Medium Enterprises (MSMEs) affected by Tsunami.	2,750.00	
Susahana Phase II	LKR	500.00	To provide 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	To grant loans to SME sector activities in the Eastern Province.	1,000.00	
Awakening North - Phase II	LKR	2,154.25	To extend credit to agriculture, livestock, micro and small enterprises in the Northern Province.	2,361.00	
Second Perennial Crops Development Project - Revolving Fund	LKR	1,200.00	To provide credit facilities to develop the perennial crops sector in the country.	1,199.82	
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 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	EUR	9.00	To strengthen the financial and technical capacities of private local businesses to effectively participate in construction and public work in post Tsunami reconstruction.	1,399.73	
Sabaragamuwa Province Integrated Rural Development Project - Phase II	LKR	70.00	To enhance and start new income generating activities in the Sabaragamuwa Province.	70.00	
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.	190.77	
Poverty Alleviation Micro Finance Project II (Probodini)	YEN	2,381.00	To enhance the living standard of households whose monthly income is less than Rs. 15,000/= in project location.	3,213.20	
Self Employment Promotion Initiative	LKR	250.00	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.	232.39	
Viskam (Special Loan 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.	881.00	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.	2,900.00	Collection of recoveries from PFIs as per scheduled date to be transferred to FD.
Dry Zone Livelihood Support & Partnership Programme	LKR	252.95	To provide facilities to income generating activities in Anuradhapura, Moneragala, Kurunegala and Badulla Districts.	252.95	
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.	1,000.00	
Resumption of Economic Activities in the Eastern Province - Phase III	LKR	1,000.00	To extend credit to agriculture, livestock, micro and small enterprises in the Eastern Province.	1,428.47	
Repair of Damaged Houses in the North and East	LKR	600.00	To provide credit facilities for repairing the damaged houses that were damaged during the conflict in the Northern and Eastern Provinces.	600.00	
National Agribusiness Development Programme	USD	32.90	To assist smallholder 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.	113.13	
Small Plantation Entrepreneurship Development Project	SDR	2.60	To enhance the living standard of the low income communities in Monaragala, Kandy, Kegalle, and Nuwara-Eliya.	487.66	
National Agribusiness Development Programme (NADeP) - Microfinance	LKR	1,049.84	To improve income level and social conditions of the poor in selected areas.	1,049.84	
Value Chain Development Capital Agriculture Loan Scheme under the "Out Grower Farmers Loan scheme" of the National Agribusiness Development Programme (NADeP)	LKR	135.69	To increase the production, productivity, quality and value addition of agriculture produce.	135.69	
Value Chain Development Seasonal Agriculture Loan Scheme under the "Out Grower Farmers Loan scheme" of the National Agribusiness Development Programme (NADeP)	LKR	302.04	To increase the production, productivity, quality and value addition of agriculture produce.	302.04	
Post-Disaster Economic Activity Recovery Loan Scheme (PEARL)	LKR	134.58	To support borrowers (individual or group of individuals) in their post disaster recovery efforts of the business/small enterprises affected by recent floods, drought by providing the fund requirements to resume their businesses or income generating activities.	134.58	
NADeP- "Tharuna Diriya" Youth Empowerment and Employment Programme	LKR	288.48	Reach village level poor youth to enhance the skill levels and capacity building by providing credit facilities to small business and other forms of self-employment projects.	288.48	
Dry Zone Livelihood Support & Partnership Programme - Revolving Fund	LKR	252.90	To provide facilities to income generating activities in Anuradhapura, Monaragala, Kurunegala and Badulla Districts.	252.89	
Small Farmers and Landless Credit Project - Revolving Fund	LKR	345.69	To promote the intensification of agricultural production by small farmers and the establishment of small scale non-farming rural enterprises.	1,564.75	

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	Special Conditions
Tea Development Project – Revolving Fund	LKR	1,100.00	To provide credit facilities to develop the tea sector in the country.	964.87		No Warranties and assurances	The rights and obligations of the agreements will not be assigned, amended, abrogated or waived without the agreement of all relevant parties
Swashakthi Loan Scheme	LKR	4,000.00	To generate employment opportunities via providing financial support for both new and existing entrepreneurs	2,146.78			
Athwela-Resumption of Economic Activities affected by Disasters (READ)	LKR	2,000.00	To provide financial facilities to eligible sub-borrowers to resume any economic activity affected by any disaster as informed by the GOSL	100.00			
Poverty Alleviation Micro-finance Project RF (Probodini)	LKR	1,031.00	Assist to set up an effective credit delivery mechanism for income generating activities conducted by the rural poor who has no access to formal credit.	4,301.45			
Poverty Alleviation Micro-finance Project II (Probodini) – Revolving Fund	LKR	2,764.84	Improve income levels of the poor and enhance inclusive formal financial services for them by providing credit for income generating activities.	6,680.66			
Saubagya Loan Scheme	LKR	22,875.47	To extend credit to MSMEs and disaster affected MSMEs.	22,875.47	Collection of recoveries from PFIs as per scheduled date to be transferred to relevant A/Cs of the RDD		
Self Employment Promotion Initiative Phase II (SEPI II)	LKR	225.00	To provide financial assistance to trained youth who completed certificate or Diploma in National Vocational Qualification (NVQ)	224.66			

52. EVENTS OCCURRING AFTER THE REPORTING DATE

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

2. BANK SUPERVISION

Bank Supervision Department (BSD) was established in terms of Section 28 of the Monetary Law Act (MLA) for the purpose of continuous supervision and periodic examinations of licensed banks in Sri Lanka. Further, the regulation and supervision of licensed banks are governed by the provisions of the Banking Act, No. 30 of 1988 as amended.

The main functions of BSD are issuing of prudential regulations and guidelines, granting regulatory approvals where necessary with the approval of the Monetary Board, conducting continuous supervision and periodic examinations of licensed banks, and engaging in awareness and capacity building of the banking sector. BSD also administered the operations of Sri Lanka Deposit Insurance and Liquidity Support Scheme (SLDILSS).

At the end of 2017, the banks falling under the regulatory and supervisory purview of the Bank Supervision Department comprised 25 licensed commercial banks (LCBs), 7 licensed specialised banks (LSBs) and 2 Representative Offices (ROs). The list of licensed banks and ROs is provided in Annex II - 1.

The main functions and activities performed by BSD during 2017 are summarised below:

2.1 Issuance of Prudential Regulations

Prudential regulations issued to licensed banks are provided in Part III of this Report. A summary of the major prudential regulations is given below.

(a) Loan to Value Ratios for Credit Facilities in respect of Motor Vehicles

Licensed banks were required to maintain Loan to Value (LTV) ratios, when granting credit facilities for the purchase or utilization of motor vehicles, as a macro-prudential measure to curtail the excessive credit in the banking sector for purchase of motor vehicles. Subsequently, licensed banks were informed of the basis of valuation of vehicles, interpretations and categorisation of vehicle classes provided by the Department of Motor Traffic (DMT) that may be used with regard to LTV ratios for credit facilities in respect of motor vehicles.

(b) Implementation of Budget Proposals 2017

Licensed banks were informed to implement necessary measures to increase distribution of credit to identified sectors, i.e., agriculture, small and medium enterprises (SMEs), exports, tourism, youth and women, and to enhance banking services in keeping with the national policy approved in the Budget 2017.

(c) Amendment to Pawning Conditions Issued to Licensed Banks

Licensed banks were required to report details of bulk purchases of pawned articles at auctions as a measure to eliminate gold smuggling.

(d) Interest Rates on Credit Products

Licensed banks were permitted to charge interest rates on credit products as per their policies and were required to publish such rates, basis of calculation and penal interest rates, if any, commencing 01 July 2017.

(e) Concessions in Respect of Credit Granted to Flood Affected Borrowers

Licensed banks were informed to grant concessions on a case-by-case basis to their borrowers who have been affected by the floods, adverse weather conditions and connected circumstances, in terms of the national policy adopted to facilitate the rehabilitation of businesses and normal operations of such borrowers in the national interest.

(f) Annual Licence Fee of Licensed Commercial Banks and Licensed Specialised Banks

Annual licence fees of the licensed banks for the calendar year 2018 were determined based on the total assets of licensed banks, as at end 2017.

(g) Enhancement of Minimum Capital Requirement

Licensed banks were required to enhance minimum capital requirements in order to strengthen the resilience of the banking sector and support the implementation of Basel III framework in Sri Lanka.

Accordingly, by 31 December 2020 existing locally incorporated licensed commercial banks are required to maintain Rs. 20 billion, banks incorporated outside Sri Lanka with assets up to Rs.100 billion are required to maintain Rs. 5 billion and banks with assets over Rs.100 billion are required to maintain Rs. 10 billion, respectively. Licensed specialised banks will need to maintain Rs. 7.5 billion.

Further, locally incorporated LCBs are required to bring in Rs. 20 billion and locally incorporated LSBs to bring in Rs. 7.5 billion, respectively, at point of entry. Banks incorporated outside Sri Lanka are required to bring in a capital of Rs. 10 billion.

(h) Financial Derivative Transactions for Licensed Commercial Banks and Licensed Specialised Banks

Commencing 01 January 2018, licensed banks were required to further strengthen risk management of derivative transactions.

(i) Foreign Currency Borrowings

Commencing 01 January 2018, licensed banks were required to comply with a new policy on foreign currency borrowings, with a view to further strengthening the risk management of foreign currency borrowings by banks. The limits on foreign currency borrowings were introduced based on a score calculated considering the bank's external credit rating and capital adequacy ratio, and linked to a certain percentage of total assets.

2.2 Approvals granted by the Monetary Board

(a) Branches, Other Banking Outlets and Representative Offices of Licensed Banks

During the year, 704 approvals were processed and 662 approvals were granted, while 42 requests were deferred/declined on prudential grounds (Table II-1). Accordingly, at end 2017, there were 3,560 bank branches, 3,059 SSUs and 4,416 ATMs in operation. Meanwhile, approval was granted for one LCB to open a subsidiary in Maldives, a letter of provisional approval was issued to Bank of China to establish a branch to operate as an LCB and approval was granted to Doha Bank QPSC to open a representative office. Representative offices of foreign banks are established with limited scope of activities and do not carry on banking businesses. Their activities are mainly focused on areas such as enhancing co-operation between Sri Lanka and the country of origin of those banks, engage in activities to facilitate trade and investments between Sri Lanka and countries where such banks already have a presence and to support Sri Lanka to develop economic co-operation globally.

Table II-1
Approvals relating to Branches and Other Banking Outlets

Types of Approvals	No. of Approvals	
	Processed	Granted
Opening and Installation		
Branches	105	75
Automated Teller Machines (ATMs)	142	136
Student Saving Units (SSUs)	143	143
Cash Deposit Machines (CDMs)	31	30
Mobile Banking Units and Vehicles	113	113
Mobile ATMs and CDMs	4	4
Relocation		
Branches	95	93
ATMs	7	6
Closures and cancellations of approvals granted for branches and other service outlets	64	62
Total	704	662

(b) Other Regulatory Approvals

During 2017, a total of 437 regulatory approvals were granted with regard to foreign borrowings by licensed banks, inclusion of debentures in Tier 2 capital, acquiring material interest in shareholding, exceeding maximum amount of accommodation, assessing fitness and propriety for appointment of new/continuing directors and key management personnel, disposal of property below market value, meeting the minimum capital requirements, outsourcing arrangements and abandoned property reimbursements.

2.3 Conduct of Continuous Supervision

- (a) Continuous supervision is an on-going monitoring mechanism on the affairs of individual banks, which serves as an early warning system to ascertain the operational efficiency and long term sustainability of the entire banking industry and enables the implementation of corrective measures where necessary, to ensure safety of depositors' funds.
- (b) Continuous supervision was conducted based on periodic financial and performance information submitted by banks through the web based FinNet System. Approximately, 69 statutory returns are submitted monthly/ quarterly/ annually for each bank through the FinNet system, covering financial and prudential information, of which, 18 returns are submitted manually. Revamping of the database maintained in BSD in consultation with IT Department continued in 2017 to facilitate better report generation. In this regard, 30 existing FinNet returns were finalised for amendment, 17 new returns were introduced and 2 returns were amended in the FinNet System to comply with new Banking Act Directions issued by BSD. In addition, the progress on addressing supervisory concerns identified during statutory examinations of banks within specified time targets were monitored on a quarterly basis during 2017.
- (c) In the process of continuous monitoring and supervision of banks, special reports were submitted with respect to banking industry loans to the construction sector, credit growth and sector concentration in the banking industry, credit to deposit ratio in the banking industry, Northern and North-Eastern Province indebtedness, credit granted to flood affected borrowers and quarterly reports on banking industry performance. In addition, banking industry aggregate data were shared with other departments of the Central Bank and external government institutions to facilitate preparation of reports.
- (d) During 2017, approximately 820 customer complaints were handled relating to loan interest rates, rescheduled loans, credit cards, pawning operations, banking malpractices and frauds, unauthorised withdrawal of funds and seeking a reduction in Automated Teller Machine (ATM) charges & fees. Further, BSD also facilitated the collection and submission of information on the reimbursement of interest on senior citizen fixed deposits held in licensed banks to the Ministry of Finance and Mass Media on a quarterly basis.
- (e) A summary of the banking sector performance from 2015 to 2017 is given in Table II-2 below. A detailed assessment is provided in Chapter 8 on Financial Sector Performance and System Stability.

Table II-2
Banking Sector Highlights

Item	As at end			Change (%)	
	2015 ^(a)	2016 ^(a)	2017 ^(b)	2015/16	2016/17
Sector Indicator (Rs. Bn)					
Total Assets	8,077	9,047	10,293	12.0	13.8
Total Loans and Advances	4,715	5,541	6,431	17.5	16.1
Total Investments	2,348	2,271	2,554	(3.3)	12.5
Total Deposits	5,403	6,296	7,399	16.5	17.5
Total Borrowings	1,758	1,696	1,607	(3.5)	(5.3)
Total Capital	661	790	871	19.5	10.2
Net Profit (After Tax)	97	116	139	19.9	19.2
Bank Branches and Other Service Outlets					
Number of Branches	3,452	3,524	3,560	n/a	n/a
Number of ATM's	3,535	3,851	4,416	n/a	n/a
Prudential Ratios (in percentage)					
Capital Adequacy Ratio	15.4	15.6	15.2	n/a	n/a
Statutory Liquid Assets Ratio	33.9	29.9	31.3	n/a	n/a
Non-Performing Loans Ratio	3.2	2.6	2.5	n/a	n/a
Return on Equity	16.2	17.3	17.6	n/a	n/a
Return on Assets	1.9	1.9	2.0	n/a	n/a

(a) Revised

(b) Provisional

2.4 Conduct of Periodic Examinations

(a) BSD conducted 38 examinations during 2017 including 06 that continued from the previous year. Examinations of 33 licensed banks were completed in 2017 through formal discussions with the management of the respective banks and submission of reports to the Monetary Board, while 05 examinations were in the process of completion. Major concerns raised at certain examinations included low capitalization and efficiency, lapses in corporate governance and management, deficiencies in technology risk management, under-estimation of non-performing loans, provision for bad and doubtful loans and concerns over treasury operations. In addition, several examinations with limited scope were conducted on areas such as document verification, investments in government securities, corporate governance, customer complaints, cash processing and unethical business practices.

(b) Further, BSD has initiated a process in 2017 for developing an internal methodology to assign ratings to licensed banks, based on a combination of quantitative and qualitative indicators attributable to banks' efficiency and sustainability. For this purpose, a Bank Sustainability Rating Indicator (BSRI) model is to be adopted to facilitate risk-based supervision. Accordingly, as a part of strengthening the on-site examinations of banks under a risk-based approach, BSD will adopt a framework to categorize the banks in deciding the frequency and scope of examinations based on the risks attributed to each bank.

2.5 Administration of the Sri Lanka Deposit Insurance and Liquidity Support Scheme (SLDILSS)

(a) As at 31 December 2017, the scheme comprised 76 member institutions with a total fund of approximately Rs. 44 billion (unaudited). Book values of the investments in government securities by the fund and the loan granted to a member institution during the year 2014, under the liquidity support facility for restructuring, as at 31 December 2017 were Rs. 39.6 billion and Rs. 6.1 billion, respectively. Financial highlights of SLDILSS is given in Table II-3 below.

Table II-3
Financial Highlights of the Sri Lanka Deposit Insurance and Liquidity Support Scheme

Item	Amount Rs.mn	
	As at 31.12.2016	As at 31.12.2017 ^(a)
Size of the fund	34,257	44,141
Total Income	9,593	12,115
Total Expenditure	753	2,230 ^(b)
Profit for the year (before tax)	8,839	9,884
Investment in Government Securities	25,700	39,646
Loans and Receivables	6,179	6,129
Available for Sale Reserve	(665)	2,392

^(a) Provisional^(b) Including taxes

(b) Licensed banks that maintained a capital adequacy ratio of 14 per cent or above at the end of the immediately preceding financial year were required to pay a premium of 0.10 per cent per annum on the total amount of all eligible deposits and all other banks were charged a premium of 0.125 per cent per annum. The premium

applicable for licensed finance companies was 0.15 per cent per annum. Premia and penalties received from member institutions during the year amounted to Rs. 8.1 billion.

- (c) With effect from 01 January 2018, the deposit insurance coverage per depositor per institution has been increased from Rs. 300,000 to Rs. 600,000.
- (d) Commencing 01 January 2018, the scheme is being operated under the newly established Resolution and Enforcement Department (RED).

2.6 Awareness and Capacity Building of the Banking Sector

(a) Capacity Building

Continuing its contribution towards building the capacity of the banking sector, BSD provided resource persons for various industry training programs and forums, covering areas such as corporate governance, risk management, banking business and laws, and regulatory developments pertaining to banking and finance, at the Centre for Banking Studies of the Central Bank of Sri Lanka and other external institutions.

Capacity building of the staff of BSD was continued in 2017 and officers of BSD participated in local and foreign training programmes in the areas of risk management, Basel III standards, stress testing, fintech, cyber security, financial reporting standards, consolidated supervision, etc.

(b) Meetings with Banks and other stakeholders

BSD continued to function as the secretariat for the monthly meetings of bank CEOs, chaired by the Governor, which are aimed at creating a dialogue between the Central Bank and the banking sector on matters relating to the developments in the Sri Lankan economy, the banking sector, and regulatory and supervisory frameworks. Additionally, two meetings of bank chairpersons were held to apprise of the banking sector performance, developments in the local and global regulatory frameworks and the economy to strengthen their decision making of licensed banks.

Regular meetings were conducted with the senior management of concerned licensed banks to discuss bank specific matters, to ensure proper oversight and timely implementation of corrective action, and meetings with the Board appointed committees of banks to ensure the sustainability of the banking sector. Further, BSD facilitated banks to obtain necessary information and clarifications on the adoption of new Sri Lanka Financial Reporting Standards, by organising meetings with the Institute of Chartered Accountants of Sri Lanka.

BSD organised a meeting of the Financial Sector Oversight Committee (FSOC), which comprises Heads of

core financial sector regulators, to facilitate cooperation among member institutions to ensure the efficiency, soundness and safety of the financial system falling within their purview. In addition, a meeting with the Chairmen of Board audit committees and auditors of licensed banks was held to discuss the collaborative approach to assess the sustainability of licensed banks. Further, BSD conducted interactive sessions with journalists, risk professionals and other stakeholders on Basel III capital regulations and participated in a supervisory college on Non-financial Risk and Outsourcing.

(c) Public Awareness Programmes

During 2017, 15 public awareness sessions were conducted by BSD on financial institutions authorised by the Central Bank, on accepting deposits from the public as well as the dangers in engaging in prohibited schemes, while the general public were informed through posters and leaflets in this regard.

Annex II - 1 List of Licensed Banks

Licensed Commercial Banks

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

Licensed Specialised Banks

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

Representative Offices of Foreign Banks

1. JP Morgan Chase Bank NA
2. The Bank of Tokyo-Mitsubishi UFJ Ltd.

3. CENTRE FOR BANKING STUDIES

Centre for Banking Studies (CBS), being the training arm of the Central Bank, continued its contribution towards the development of human capital of the Central Bank and the financial sector by way of conducting a wide range of training programmes, seminars and workshops during the year under review.

In line with the Central Bank Corporate Strategic Objective of capacity building and support and to cater to the demands of the financial sector, CBS offered training programmes covering the areas of commercial banking operations, risk management and compliance, treasury operations, accounting and financial management, credit management, laws and regulations, development banking, research and data analysis, economics, information technology and human resource management. Accordingly, CBS offered 54 calendar programmes, 41 special tailor-made programmes, 3 certificate programmes, 4 educational seminars and 9 knowledge sharing events in the form of public lectures. Further, 4 international programmes were successfully conducted in collaboration with the IMF and the SEACEN Centre.

CBS took special efforts to enhance competencies of Bank staff on core-central banking, by conducting 5 specially designed programmes with the assistance of international expertise from the Reserve Bank of India (RBI) and the Deutsche Bundesbank. These programmes were cost effective and very popular among the staff. Further, the CBS conducted 3 special training programmes for Management Trainees and Banking Assistants recruited to the Central Bank in 2016, on request of the Human Resources and Training and Development Departments.

To promote economic education and financial inclusion at the regional level, 11 seminars and 12 special programmes were offered in collaboration with the Regional Offices and Regional Office Management Department. Two popular educational television series titled "Thakshilawa" and "Ariwootroo" were telecast targeting the Advanced Level students. In total, 146 programmes were conducted by the CBS in 2017. These programmes were attended by 6,250 participants, including 126 foreign delegates from Nepal, Bangladesh, Bhutan, Maldives, Indonesia, Malaysia, Papua New Guinea, South Korea, Cambodia, Myanmar, Brunei, Seychelles and Thailand.

The Programme Calendar for 2018 was prepared with careful assessment of the present and future training needs of the Central Bank and financial sector. CBS also conducted in depth post evaluation processes, to improve programme modules and other services, and strive to maintain high standards in all aspects of its programmes.

4. COMMUNICATIONS

Through the dissemination of information to its stakeholders, by way of external and internal communication approaches, public awareness programmes, quiz programmes through electronic media and the services of the Library and

Information Centre, the Communications Department (CMD) strengthened its role by extending its support to accomplish the mission of the Central Bank in maintaining economic and price stability and financial system stability during 2017.

4.1 External Communications

The revamping of the Central Bank corporate website together with the Information Technology Department (ITD) was one of the main tasks of the CMD. The aim of creating a website with state of the art features posed a major challenge to the department and this had been continued since the previous year, by a task force established for this purpose. The new website, which is to be in all three languages Sinhala, Tamil and English, is due to be launched in 2018.

During the year 2017, CMD issued 1,115 press releases (including 183 key releases such as Monetary Policy Review, External Sector Performance and Inflation etc.), 5 Gazette notifications and 135 notices in the media (including advertisements). Further, to improve communication with stakeholders of the Central Bank, CMD administers and monitors its corporate social media accounts namely, twitter, facebook and YouTube. A comparison of the performance with respect to the Central Bank social media accounts in 2016 and 2017 are specified in Table II-4 below.

Table II-4
Details of Central Bank Social Media Communications

Type of media	2016	2017
YouTube (CBSL video uploads)	54	63
YouTube Views (Cumulative)	131,000	177,454
Facebook Likes (Cumulative)	11,630	18,146
Twitter Followers (Cumulative)	8,791	17,990

In addition, 15 press briefings on various important policy matters relevant to the Bank were held during 2017. Further, CMD facilitated the Bank's events such as the Central Bank 67th Anniversary Oration on "Macroeconomic Stabilisation and Structured Reforms: Pakistan's Recent Experience with IMF", delivered by Mr. Ashraf Mehmood Wathra, former Governor of the State Bank of Pakistan and 5 public lectures including the presentation of the Annual Report 2016, organized by Centre for Banking Studies (CBS). Apart from that, CMD facilitated the Central Bank's events such as the 21st Commemoration of the victims of the Central Bank bomb attack, the Road Map and 34th SAARCFINANCE Group meeting & SAARCFINANCE Governors' Symposium, the Asian Clearing Union Standing Technical Committee meeting and the Asia-Pacific Group on Money Launderings 20th Annual Meeting and the Technical Assistance meeting.

CMD participated in the "Colombo International Book Fair" (CIBF) held at the Bandaranaike Memorial International Conference Hall Colombo from 15th to 24th September 2017, with the objective of enhancing public awareness on Central Bank policies, activities, programmes on regional development and other related matters through the sale and distribution of Central Bank publications.

The CMD handled grievances directed to the Central Bank through the “Tell the President Grievance Handling System” and responded to 86 grievances in 2017 after coordinating with respective departments in the bank.

In March 2017, the CMD was also assigned with the task of coordinating requests from citizens under the Right to Information (RTI) Act No. 12 of 2016. The CMD handled 71 requests and 12 appeals and responded to them with the assistance of relevant departments.

4.2 Internal Communication

To enable the senior management to be well informed of the current affairs of the economy, the financial sector and matters relevant to the bank, CMD submitted 8,466 news clips, articles and public opinions extracted from fifteen national newspapers published in three languages, to the senior management.

CMD continued publishing the official internal newsletter, “Kavuluwa” (meaning “window”), with two issues during the year.

4.3 Public Awareness

Season III of the “Econ Icon” Inter-School TV Quiz Programme, which was initiated with the aim to enhance the economic literacy of the school children of the country, was successfully completed with a Grand Finale in both Sinhala and Tamil mediums, in February 2017.

Awareness programmes covering diverse topics such as Objectives and Functions of the Central Bank, Sri Lankan economy etc. were coordinated by CMD for 7,289 participants, as given in Table II-5. Apart from that, 17 programmes were coordinated by CMD, which were held outside the Central Bank Head Office, while sharing knowledge among more than 2500 stakeholders.

Table II-5
Details of Public Awareness Programmes
Conducted in 2017

Institution	No. of Programmes	No. of Participants
Schools	100	6,776
Universities	6	289
Sri Lanka Armed Forces and Defense University	4	106
Foreign Delegates (National Defense Colleges)	5	118
School teachers, students and Govt. Servants thro’ Regional Offices	5	NA
Mobile Programmes (Organized by CMD)	17	2,500

CMD resource persons participated in the “Arivootru” (meaning “Spring of Knowledge”) TV Programme conducted by CBS of the Central Bank. Further, CMD assisted 5 awareness programmes initiated by Regional Offices, by providing resource persons and publications.

CMD carried out sales of Central Bank Publications amounting to Rs. 5.6 million during the year through its sales counter at

the Economic History Museum, the CBS publications store at Rajagiriya, sales divisions of Regional Offices and at the CIBF. CMD also distributed 16,698 copies of different publications free of charge among school and Public Libraries throughout the country.

CMD initiated a successful Open Day Programme (ODP) at the Regional Office, Matale on 5th and 6th May 2017, which was an awareness programme to educate the general public and school children of the Central Province about the functions and services of the Central Bank. In addition, visitors had the opportunity to access services provided by the Central Bank and have their grievances/ complaints addressed.

4.4 Tamil Translation Services

The Tamil Translation Unit continued to provide invaluable services to enable the release of all communications, including major publications of the Central Bank, in Tamil, thereby contributing its share to the CMD’s mission of providing information in all three languages, in compliance with the National Language Policy.

4.5 Photography and Videography Coverage

The Photographic Unit of the CMD Media Division provided its service by covering major events of the Bank through visual media. The Unit covered 730 events of the Bank in 2017, compared to 379 events in 2016. The unit maintained high professional standards by delivering all related services including editing, printing of photographs, preparing albums and CDs, uploading to the Central Bank website and Mansala (Intranet).

4.6 Printing Press

CMD provided the services of designing, typesetting and printing to meet the printing requirements of the Central Bank with high quality standards. In this respect, the Central Bank’s Printing Press completed a total of 219 printing assignments in 2017. These include periodicals such as Satahana (04 Volumes), News Survey (02 Volumes), Kurippedu/Vaippaham (03 Volumes), Kavuluwa, Sendewa, books such as “A Survey of the Financial System”, “Strategic Plan 2017 – 2021”, “A Guide to Financial Services in Sri Lanka” (in all three languages), Functions and Objectives of the Central Bank (Sinhala), “Mudal Ganudenu, Banku Ha Arthikaya” and “Uddamanaye Kathawa”. Further, printing of colour posters, handbills, leaflets, letterheads, all kinds of certificate requirements for the Central Bank, visiting cards, all kinds of forms and greeting cards were undertaken.

4.7 Library and Information Centre

The Library and Information Centre (LIC) is the knowledge hub of the Central Bank. It is the key resource center that enhances the knowledge of the Bank staff as well as permitted external users such as university students and researchers. It serves them with a collection of 30,600 books, 19,500 reports, 1,935 CD’s, inclusive of new additions of 667 books, 153 reports,

77 CDs during the year and over 48,000 journal issues. The LIC subscribes to online databases, such as 'ScienceDirect' and 'EconLit', which provides access to a vast knowledge of information especially on economics, management and finance. In addition, the LIC subscribed to several other online resources on subjects relevant to central banking activities. Among them access has been set to www.centralbanking.com, www.risk.net and www.ft.com throughout the bank premises in order of easy access to information.

Subscribing to the OpenAthens is a major achievement in the year 2017, which provides access to the officers even from their residence. Also, the LIC subscription to Wiley Online Journals provided access to more than 12 Online Journals at once.

The LIC subscribes to 83 Foreign Journals and 17 Local Journals, respectively. In addition, it continued to compile electronic bulletins such as Recent Additions (i.e. new books), Current Contents, International News Alert, Local Press and notes on Economics, banking and finance related reports and disseminated them via the intranet. A local press has been setup to cover English, Sinhala and Tamil Newspapers to comply with language policy wherever possible. A selective dissemination of information services was also provided.

The LIC continued its services to the banking and economics libraries in Sri Lanka by providing useful information through emails and inter library loans. Further, the LIC was an active member of the Global Central Bank and Financial Institutions Library and Information Professionals' Network (CBFA List), which shares information resources and experience among the central banks and other international financial institutions across the globe. A digital library service was also maintained, giving access to the Bank staff through the library's intranet website.

5. CURRENCY

The Central Bank of Sri Lanka has the sole right and authority to issue currency in Sri Lanka which includes both currency notes and coins as stipulated in the Monetary Law Act (MLA) No. 58 of 1949. In fulfilling this task, the Central Bank is entrusted with designing, printing of currency notes, minting of coins and distributing of currency notes and coins.

Currency Department of the Central Bank handles functions relating to this statutory responsibility of the Monetary Board. CRD continuously engages in building and maintaining public confidence in the currency by preserving its value and integrity and making available adequate stocks to meet the demand for currency, which is essential for smooth functioning of the economy.

5.1. Currency Printing and Minting

During 2017, CRD made arrangements to print 270 million pieces of currency notes and 970 million pieces of coins, in order to meet the demand for currency notes in the

economy and the respective deliveries will be made in the coming years, to ensure good quality notes in circulation and ensure sufficient stocks to meet the public demand.

The arrangements were also made to design a new set of circulation standard coins from metal of stainless steel for the denominations of Rupee 1, Rupees 2, Rupees 5 and Rupees 10 reducing the sizes of coins. This new coin series is expected to reduce the cost of minting and ease the handling of coins.

5.2. Currency Distribution

(a) Currency in Circulation

Demand for currency notes and coins increased in 2017 in line with the economic growth and inflation in Sri Lankan economy, notwithstanding the continued usage of technology driven non-cash modes of payment.

Accordingly, the value of total currency in circulation increased by 8.3 per cent to Rs.598 billion as at 31 December 2017, over the previous year, as shown in Table 6.

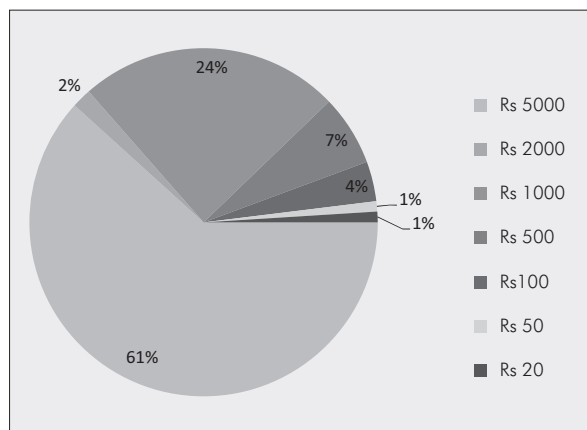
Table II-6
Currency in Circulation as at 31.12.2017

Item	Value (Rs. bn)					Change (%)				
	2013	2014	2015	2016	2017	2013	2014	2015	2016	2017
Notes	332.4	408.8	482.0	541.5	585.3	6.8	23.0	17.9	12.3	8.0
Coins ^(a)	6.8	7.5	9.1	10.7	12.1	7.5	10.3	21.3	17.5	13.0
Total	339.2	416.3	491.1	552.2	597.4	6.8	22.7	18.0	12.4	8.3

^(a) The commemorative coins that are not in circulation are excluded

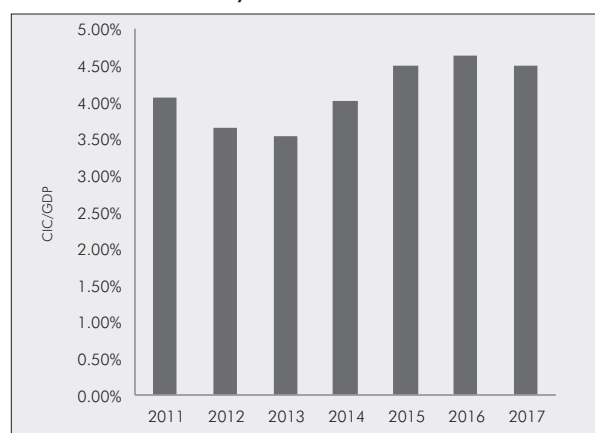
The value of currency notes in circulation increased by 8.0 percent to Rs 585.3 billion in 2017. Among the currency notes, the denominations of Rs 5000 and Rs 1000 together accounted for approximately 85.8 per cent of the total value of currency notes in circulation as at 31 December 2017 as given in Chart 1.

Chart II-1
Value of Bank Notes in Circulation



The ratio of currency held by the public (in circulation) to GDP which was 4.0 per cent in 2011 was around 4.50 per cent at end of 2017, demonstrating an increasing demand for currency as an important mode of payment in the country (Chart 2).

Chart II-2
Currency in Circulation/GDP



(b) Currency issues to Licensed Commercial Banks

In order to meet the public demand for currency notes and coins, CRD continued to ensure the regular supply of currency notes and coins through Licensed Commercial Banks (LCBs) and the special public counter established at the Pettah Branch of Bank of Ceylon.

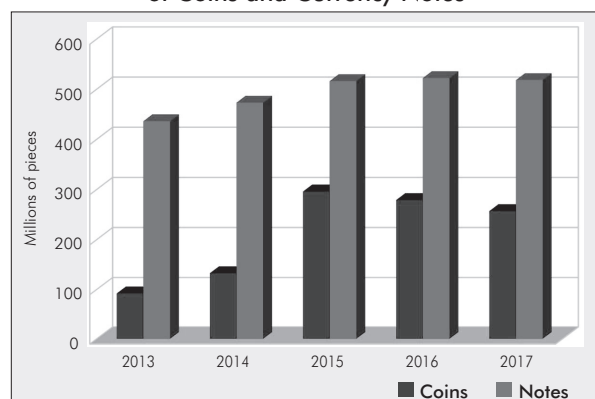
Accordingly, currency notes and coins issued by CRD for circulation of the country during the year 2017, amounted to Rs. 628.0 billion and Rs. 1.4 billion, respectively (Table 7).

Table II - 7
Currency Notes and Coins issued to LCBs

Item	Value (Rs. bn)			
	2014	2015	2016	2017
Notes	431.8	503.4	594.0	628.0
Coins	0.8	1.6	1.6	1.4
Total	432.6	505.0	595.6	629.4

CRD took initiative to develop a new mechanism for island wide coin distribution, to meet the regional level coin requirement. Accordingly, CRD considered a proposal to distribute coins to the regional level of the country through Regional Offices of the Central Bank.

Chart II-3
Currency Issues - Number of Pieces of Coins and Currency Notes



(c) Acceptance of Currency Deposits from LCBs

As a part of currency operations, CRD accepts currency deposits from LCBs, primarily for the maintenance of the statutory reserve requirement imposed by the Central Bank as a monetary policy tool. During 2017, CRD accepted both serviceable (fit) and unserviceable (unfit) currency notes from LCBs, as given in Table 8. In 2017, currency deposits of LCBs with CRD increased by 9.2 per cent when compared to the previous year.

Table II - 8
Currency Deposits by LCBs

Item	Value (Rs. bn)			Change (%)		
	2015	2016	2017	2015	2016	2017
Notes	429.6	534.5	584.0	21.1	24.4	9.2

Note : The value of coins deposited by LCBs with CBSL is not significant

(d) Issue of Commemorative Coins and sales of commemorative collector items

In January 2017, CRD issued an uncirculated silver commemorative coin with a face value of Rs. 2000 to mark the 100th Anniversary of Visakha Vidyalaya, Colombo 05 in recognition of its contribution to the nation as a premier school in the country.

A circulation standard commemorative coin with a face value of Rs. 10 was issued in July 2017 to celebrate 150 years of Ceylon Tea and to recognise its contribution to the national economy as an important and long-standing export oriented commodity in Sri Lanka.

The Central Bank issued a commemorative currency note to mark the 70th independence celebration of the country, in February 2018.

In addition, commemorative collector items were sold through the CBSL Regional Offices and the Economic History Museum in Fort, Colombo.

5.3 Clean Note Policy

CRD implemented the Clean Note Policy during the past several years with the objective of ensuring good quality currency notes in circulation in the country, while withdrawing unfit/unserviceable currency notes from circulation.

Since clean currency notes in circulation reflect a positive image of the country, CRD initiated several actions to strengthen the Clean Note Policy in 2017.

During 2017, CRD continued to ensure the regular supply of good quality (fit) currency notes and disposal of unfit currency notes, by destroying 177 million pieces of unfit currency notes deposited by LCBs, amounting to a face value of Rs. 94.2 billion. CRD reissued in to circulation 311.7 million pieces of serviceable currency notes amounting to Rs 504.6 billion.

CRD took measures to strictly enforce the law on willful mutilation, alteration and defacement of currency notes, considering the increased number of willfully mutilated, altered

and/or defaced currency notes among the currency deposits of LCBs on a regular basis.

A sound awareness campaign was conducted to educate the general public to refrain from such practices and informed to exchange such currency notes in their possession before 31 December 2017 as no claims on such currency notes will be accepted after 31 December 2017¹.

CRD conducted meetings with cash managers of LCBs, to discuss currency related issues to improve the efficiency and effectiveness in currency management and operations among LCBs and matters relating to the developments in the currency sorting and handling practices, to extend the effective life of currency notes.

5.4 Assistance Provided to Law Enforcement Authorities

During 2017, CRD continued facilitating law enforcement authorities regarding violation of the provisions of MLA on counterfeiting of currency as follows;

- (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 2017 amounted to 5,812 pieces. The ratio of counterfeit currency notes in circulation which is measured by parts per million, was 5 during 2017.
- (b) Endorsed and issued 138 certificates in terms of section 59 of the MLA with the signature of the Governor, as conclusive evidence for the imitation of currency note, to facilitate proceedings in courts.
- (c) Attended 10 court cases to give evidence on currency counterfeiting.

5.5 Public Awareness

CRD conducted several public awareness programmes during 2017, targeting the general public, police officers, staff of LCBs and other financial institutions, teachers, students and public officials, to educate them/general public on the history of Sri Lanka currency, security features of Sri Lanka currency notes, good handling practices of currency and on the effective use of coins as follows;

- (a) Conducted 31 seminars/workshops at the Center for Banking Studies, various LCBs, police stations and at national schools, etc.
- (b) Displayed the mobile currency museum at 15 exhibitions around the country.
- (c) Facilitated about 8,760 visitors, mainly school children, tourists and general public at the three currency museums of the Central Bank and distributed information material and leaflets, highlighting the clean note policy and consequences of counterfeiting currency notes.

¹ Considering the immense requests made by the general public and the difficulties faced by the general public when exchanging such currency notes, the time period to exchange such currency notes was extended until 31 March 2018.

- (d) Conducted 05 discussion programs through leading TV channels and radio.

5.6 Approvals for Reproduction of currency notes

In terms of the policy approved by the Monetary Board, nine approvals were granted for reproduction of currency notes in 2017.

5.7 System Improvements

CRD initiated actions to ensure the inspection of every single currency note at the end of the production line at the printer, in order to enhance the quality standard of the currency notes issued by the Central Bank. Several initiatives were taken to automate currency requisition and issuance in order to improve efficiency and effectiveness of currency operations.

6. DOMESTIC OPERATIONS

6.1 Functions of DOD

The Domestic Operations Department (DOD) is entrusted with several functions, as provided for in the Monetary Law Act (MLA). They are (a) conducting Open Market Operations (OMO), (b) regulation of the statutory reserves of commercial banks, (c) acting as the banker and the official depository of the government, government agencies and other institutions acting on behalf of the government, and banker to commercial banks (d) providing temporary advances to the government, (e) maintaining accounts for dealer direct participants (f) provision of intraday credit to the participants and non-dealer bidders and (g) engaging in credit operations with banking institutions, as and when necessary.

6.2 Implementation of Monetary Policy

The Department continued to implement monetary policy with the objective of maintaining short-term interest rates at a level commensurate with the prevailing monetary policy stance of the Central Bank. In steering the Average Weighted Call Money Rate (AWCMR) towards the desired level, DOD relied mainly on OMO. Standing facilities meanwhile, continued to be available to market participants.

Inter-bank money market liquidity, which recorded a high level of excess at the beginning of the year, primarily as a result of the Central Bank's claims on the government increasing since the end of the previous year, declined thereafter and from mid-February till mid-July, fluctuated between surplus and deficit levels. This situation however changed, mainly as a result of the Central Bank's purchases of foreign exchange from the domestic foreign exchange market from around mid-July, as a result of which money market liquidity continued to increase till the end of the year.

When the market had excess liquidity, the excess liquidity was absorbed on a temporary basis through short-term and long-term repo auctions and on a permanent basis by way of outright sales of Treasury bills. Reverse repo auctions

were conducted to provide liquidity in times of shortages of liquidity, in addition to liquidity provision through the standing lending facility.

The Bond Borrowing Programme, where the Central Bank borrows Treasury bonds from the Employees Provident Fund to provide as collateral for transactions under Repo auctions, was revived in November 2017, as the Central Bank's holdings of Treasury bills were inadequate for OMO purposes.

Access to real time accurate information on money market transactions is critical to facilitating the price discovery process in the money market. DOD introduced an online system to Authorized Money Brokers (AMBs) in 2016 to report details of transactions handled by them. This system was further developed into a new system called the Central Integrated Market Monitor (CIMM) in 2017. All participating institutions (PIs) (Licensed Commercial Banks, Primary Dealers and EPF) and AMBs report their transactions in the call, government securities and foreign exchange markets through the CIMM which came into operation in January 2018. Further, LCBs also report their daily liquidity position through the CIMM. The CIMM replaced several reporting systems that existed previously, namely, the Money Brokers Reporting System, Money Market Monitoring System, Liquidity Monitoring System, and Videsha Vinimaya System. The CIMM captures vital market information of the call, government securities and foreign exchange markets.

6.2.1 Open Market Operations (OMO)

(a) Liquidity forecast

DOD makes a market liquidity forecast on a daily basis to determine the types and tenors of OMO to be conducted on a particular day. To forecast liquidity, the monetary policy actions and autonomous factors are taken into consideration. Autonomous factors include currency in circulation, FX transactions of the Central Bank, commercial bank reserve positions and transactions of the Central Bank with the government. Based on the outcome of such daily forecasts of money market liquidity, the following OMOs were conducted in 2017.

(b) Auctions

(i) Repo Auctions

Overnight repo auctions were conducted on 163 days in 2017, in order to absorb liquidity on an overnight basis when the money market liquidity was in surplus. The offered and accepted amounts at these auctions totaled Rs. 4,284.5 billion and Rs. 3,261.5 billion, respectively. The weighted average yield rates at these auctions were in a range of 7.25 per cent to 7.75 per cent.

Short-term auctions are conducted as a strategy to absorb liquidity up to one week on a same day settlement basis. DOD conducted 8 short-term repo auctions where a total of Rs. 115.0 billion was

offered, of which only Rs. 49.2 billion was accepted at weighted average yield rates ranging between 7.31 per cent and 7.43 per cent.

Long-term repo auctions are conducted with a view to absorbing market liquidity for a period of beyond 7 days. A total of 11 long term repo auctions were conducted in the months of January and September 2017, with a total offered volume of Rs. 225.0 billion. Bids were accepted at only 2 auctions. The accepted bids totalled Rs. 17.0 billion. The weighted average yield rate at these two auctions was 7.44 per cent. The tenures of the long-term repo auctions varied between 08 days and 16 days.

(ii) Reverse Repo Auctions

Overnight reverse repo auctions were conducted on 66 days in order to inject liquidity when the money market was in deficit. The offered and accepted amounts at these auctions totaled Rs. 1,292.0 billion and Rs 1,049.6 billion, respectively. The weighted average yield rates at these auctions were in a range of 8.47 per cent to 8.75 per cent. DOD did not conduct short-term and long-term Reverse Repo auctions during the year 2017.

(c) Outright Transactions

Auctions for the outright sale of Treasury bills are conducted to absorb excess liquidity on a permanent basis. DOD conducted 71 outright sales auctions in 2017, offering Treasury bills worth Rs. 380.0 billion. Bids were accepted only at 40 auctions. The total amount absorbed through these auctions was Rs. 110.3 billion. The weighted average yield rates at these auctions were in a range of 7.78 per cent to 9.23 per cent. No bids were received at 20 auctions conducted and bids received at 11 auctions were rejected. DOD did not conduct any auctions for the outright purchase of Treasury bills during the year 2017.

6.2.2. Standing Facility

Standing facilities were provided throughout the year at the Standing Deposit Facility Rate (SDFR) and the Standing Lending Facility Rate (SLFR) to PIs, which were unable to meet their short-term liquidity requirements fully through the inter-bank money market and OMO auctions. Standing Deposit Facility (SDF) transactions recorded a daily average of Rs. 16.4 billion in 2017, having recorded a total volume of Rs. 3,954.9 billion for the year 2017. The total volume lent under the Standing Lending Facility (SLF) was Rs. 2,129.5 billion in 2017, with a daily average volume of Rs. 8.8 billion.

6.2.3 Statutory Reserve Ratio (SRR)

The SRR determines the minimum amount of reserves that each commercial bank is required to hold, in the reserve account with the Central Bank, in terms of the regulations of the Central Bank, in proportion to the total rupee deposit liabilities of the respective bank. DOD is responsible for both administering the maintenance of statutory reserves as per the SRR and

monitoring compliance by commercial banks in this regard. The SRR, which was revised upward to 7.5 per cent to be effective from 16 January 2016 remained unchanged at that level during 2017.

6.2.4 Bank Rate

The Bank Rate is the rate of interest at which the Central Bank provides short term advances to Licensed Commercial Banks (LCBs) under Section 87 of the Monetary Law Act (MLA). The Bank Rate remained unchanged at 15 per cent in 2017. However, the Central Bank did not lend funds to any LCB at this rate during 2017.

6.3 Banker to Commercial Banks and the Government

6.3.1 Accounts of Financial Institutions

Performing the functions relating to the Central Bank's role as the banker to banks, DOD continued to provide current account facilities to LCBs. Given that Primary Dealers are participants of the Real Time Gross Settlement (RTGS) system and are Central Bank's counterparties in relation to OMO and standing facilities, DOD continued to operate current accounts for Primary Dealers and provided related facilities to them. These functions of DOD facilitated the smooth operation of the payment and settlement systems of the country. At the end of 2017, the Central Bank maintained accounts for 25 LCBs and 8 PDs. These accounts were operated on a real time gross settlement basis.

6.3.2 Government Accounts

Performing the functions relating to the Central Bank's role as the banker to the government, DOD continued to maintain the accounts of government departments, agencies and statutory boards, and provided the required banking facilities to them. The total number of accounts maintained by the Central Bank amounted to 61 as at end 2017. DOD handled 20,114 transactions amounting to Rs. 15,767.4 billion, during the year, on behalf of the government. More than 90 per cent of such transactions were in relation to the Deputy Secretary to the Treasury (DST) Account, the Public Debt Department's Current Account, the Inland Revenue Commissioner's VAT Refund Account and the President's Fund Account.

In terms of Section 89 of the MLA, the Central Bank provides provisional advances to the government, free of charge, with a ceiling of 10 per cent of the estimated government revenue approved by the parliament for a given fiscal year. At the beginning of 2017, the amount of the provisional advance was increased by Rs. 18.8 billion to Rs. 203.9 billion, based on the government's revenue estimated for the year 2017 and approved by the Parliament, compared to that of Rs. 185.1 billion for the year 2016.

6.4 Provision of Intra-Day Liquidity Facility (ILF)

DOD contributed towards the smooth and efficient functioning of the RTGS system by making available intra-day funding through the ILF to Pls. This facility was provided

free of charge against the collateral of Treasury bills and Treasury 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. 11,428 billion and Rs. 47.4 billion, respectively. This shows an increase in ILF utilisation over that of the previous year which amounted to a total of Rs. 9,351 billion with a daily average of Rs. 38.8 billion.

6.5 Supervision of Authorised Money Brokers

With effect from 5th March 2018, the Money Broking Regulations No. 1 of 2018 repealed and replaced the Money Broking Regulations No. 1 of 2013 as amended by the Money Broking Regulations No. 1 of 2016. These regulations are expected to be more effective in facilitating and guiding the Money Brokers' role in the price discovery process in the money, foreign exchange and government securities markets. As at end March 2018, a total of nine companies have been issued the "Certificate of Authorisation" under these regulations, which are designated as "Authorised Money Brokers" (AMBs). During the year 2017, 10 meetings were held by the DOD with the Boards of Directors of these companies while the DOD conducted 8 on-site examinations. Further, in 2017, DOD took regulatory action against an AMB for violating the Money Broking Regulations.

List of Money Brokers

1. Bartleet Mecklai & Roy (Pvt) Ltd
2. First Alliance Money Brokers (Pvt) Ltd
3. George Steuart Investments (Pvt) Ltd
4. MVS Money Brokers Ltd
5. Central Forex & Money Brokers Ltd
6. Piggot Chapman & Company (Pvt) Ltd
7. SMB Money Brokers (Pvt) Ltd
8. Taprobane Investments (Pvt) Ltd
9. Vishwin Money & Exchange Brokers Ltd

7. ECONOMIC RESEARCH

Economic Research Department (ERD) was formed in 1950 at the time of the establishment of the Central Bank under the Monetary Law Act (MLA) No. 58 of 1949. As the "Economic Think Tank" of the Central Bank, ERD was conferred with the function of preparing data and conducting economic research for the purpose of guiding 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. ERD performed its main duties with the view of maintaining economic and price stability and maintaining external sector stability. Further, in discharging the role of the CBSL as the economic advisor to the government, ERD continued to provide recommendations and policy advice to the government on emerging economic issues and fiscal policy measures required for maintaining macroeconomic

stability while analysing the impact of fiscal policy measures already adopted. Moreover, ERD continued to engage in policy research facilitating effective policy formulation and meeting statutory requirements of publication of annual report and other statutory reports. In addition, ERD continued to disseminate information and data to all stakeholders of the economy including the general public, and maintain a close relationship with international organisations on behalf of the government.

In 2017, the Department was restructured to formulate a “Real Sector” Division by amalgamating three existing divisions namely, Economic and Social Overheads Division, Agriculture Division and Industry Division. Streamlining of divisions within the Department enabled ERD to improve the quality and depth of analyses while managing the staff strength effectively during the year.

7.1 Maintaining Economic and Price Stability

While facilitating the Central Bank to conduct monetary policy to achieve economic and price stability, which is a key requirement to foster an environment conducive for sustained growth and higher living standards for the people, ERD continued to monitor macroeconomic developments closely, both in domestic and external fronts, to facilitate proactive policy actions where needed. Accordingly, as the secretariat of the Monetary Policy Committee (MPC), ERD facilitated its deliberations with its comprehensive forward looking analyses of economic and monetary conditions using continued surveillance of model based macroeconomic projections, macroeconomic statistics and estimates together with expert judgement, enabling the MPC to provide proactive policy advice to the Monetary Board in the conduct of monetary policy. ERD assisted the Governor to prepare the annual policy statement on “Monetary and Financial Sector Policies for 2017 and Beyond” (Road Map), where the CBSL announced that the conduct of monetary policy will be strengthened through the move towards a flexible inflation targeting (FIT) framework to preserve price stability with a medium term focus within a market based exchange rate system, while supporting real sector stability. In line with this decision, ERD incorporated a forward looking policy analysis and medium-term outlook into the monetary policy process based on its medium-term model projections at MPC meetings since June 2017. Several inter-departmental and staff level pre MPC discussions were also added to the monetary policy decision making process. Meanwhile, the number of MPC meetings per annum was reduced from 12 to 8, allowing more time for the staff to conduct deeper economic analysis and provide better inputs to the MPC and the Monetary Board. These changes are expected to facilitate the CBSL to gradually prepare for the move towards FIT. The CBSL re-established the Monetary Policy Consultative Committee (MPCC), with ERD providing secretariat assistance to the Committee, in order to obtain stakeholders’ views and align the policies in a way that is mutually beneficial to stakeholders and the Central Bank. ERD also compiled

Monetary Statistics based on the IMF Manual on Monetary and Financial Statistics (MFS) - 2016, which was submitted to the IMF to be published in International Financial Statistics (IFS). ERD continued to work with the IMF Technical Assistance (TA) mission on macroeconomic modelling in 2017 to improve the robustness of the monetary policy decision-making process based on the medium-term Forecasting and Policy Analysis System (FPAS), complemented by several satellite models. In addition, ERD worked with an IMF Technical Assistance (TA) mission on Monetary and Exchange Rate Policy Design to develop a comprehensive roadmap towards transitioning to a FIT framework by 2020.

7.2 Maintaining External Sector Stability

With the aim of assisting the maintenance of external sector stability of the economy, ERD continued to conduct comprehensive assessments of global and domestic economic developments and provided appropriate policy advice and recommendations. Analyses on external sector developments, which are based on external sector statistics related to international trade and finance as well as the movements of nominal and real exchange rates, were reported to the MPC and the Monetary Board to facilitate appropriate policy decision making. While monitoring market developments to identify any pressure on the exchange rate and the possible impact on gross official reserves, ERD continued to evaluate the monetary policy implications of numerous foreign loans to be obtained by the government, as per the provisions set out in the MLA.

Further, ERD was instrumental in continuously monitoring the progress in relation to the quantitative performance criteria, indicative targets and structural benchmarks agreed upon under the three year Extended Fund Facility (EFF) of SDR 1.1 billion (approximately USD 1.5 billion) from the IMF and provided regular updates to the senior management to assist decision making. Accordingly, as the focal point of coordinating the IMF-EFF programme, ERD engaged in negotiations and discussions related to programme targets and performance, with the assistance of other relevant Departments of the CBSL and relevant Ministries.

Several initiatives were taken by ERD during the year in order to improve the compilation and dissemination of external sector statistics to comply with internationally accepted data reporting standards. Accordingly, merchandise trade statistics were compiled as per Standard International Trade Classification (SITC) Revision 04, and data is published under the new classification along with the existing classification in the Annual Report 2017. ERD continued the publication of Balance of Payments (BOP) statistics and International Investment Position (IIP) statistics in the BPM6 format on a quarterly basis and International Reserve Data Template (RDT) on a monthly basis while making timely submissions related to Quarterly External Debt Statistics (QEDS) to the World Bank and direct investment data to the Coordinated Direct Investment Survey (CDIS) on an annual basis. During the year, ERD successfully

disseminated data according to the Advance Release Calendar of the Special Data Dissemination Standard (SDDS) of the IMF. Moreover, ERD conducted several surveys during the year to ensure accuracy and timeliness of external sector data. These surveys included Annual International Investment Survey (AIIS), which was used to collect data on foreign assets and liabilities of the private sector and surveys related to trade in services covering a number of industries such as IT, transportation, telecommunication, construction and insurance. The monthly survey with commercial banks on inward workers' remittances was also continued during the year.

7.3 Providing Proactive Policy Advice

ERD continued to provide policy advice to the senior management of the Central Bank, government and other stakeholders, mainly on monetary policy, exchange rate policy, growth policy and fiscal sector related issues in 2017 as well. In compliance with Section 116(1) of the MLA, the September 15th Report, a confidential report which highlights the developments in the economy over the first half of the year, was submitted to the Hon. Minister of Finance. This report also included policy proposals that may be used in the preparation of the budget for 2018. In addition, ERD provided policy assessments and advice to the Hon. Minister of Finance as statutorily required under various sections of the MLA. In addition, ERD played a key role in the preparation of the Government's Vision 2025 policy document and provided technical inputs to the National Economic Council (NEC) and the Cabinet Committee on Economic Management (CCEM). Moreover, ERD provided independent observations on macroeconomic implications on a number of Cabinet Papers as well as on several policy documents such as the National Trade Policy and National Export Strategy (NES) during the year.

Director of ERD served as a member of several committees including the Monetary Policy Committee (MPC), the Market Operations Committee (MOC), the Financial System Stability Committee, the Domestic Debt Management Committee (DDMC), the Foreign Exchange Reserve Management Committee (FRMC), the Tender Board for the issuance of Treasury bills and Treasury bonds, Investment Oversight Committee, the Risk Management Committee and the Training Committee. In addition to serving in the MPC of the Central Bank which is coordinated by ERD, senior officers of ERD continued to serve as members of a number of internal committees such as the MPC, the MOC, the DDMC, Investment Committee (IC), Foreign Reserve Management Committee (FRMC), Committee to decide prudential level of Central Bank capital, Working Committee for Implementing FIT, Steering Committee on Implementing a Road Map for Sustainable Finance in Sri Lanka, Library Advisory Committee (LAC) and Research Publications Committee (RPC) and Committees on Forecasting and Policy Analysis System (FPAS) and Revamping the FINNET System.

ERD staff continued to serve as members in numerous committees and boards of several external institutions and

provided relevant policy guidance. Such representations included committees and boards related to Hector Kobbekaduwa Agrarian Research and Training Institute (HARTI), National Science Foundation, Sri Lanka Export Credit Insurance Corporation, Ministry of National Policies and Economic Affairs, Ministry of Finance and Mass Media, Ministry of Power and Energy and Ceylon Electricity Board. In addition, Technical Evaluation Committees on the Project of constructing a powerplant at Keralapitiya, Project Committees on Rehabilitation of Elephantpass Saltern Ltd., Restructuring of the Paranthan Chemicals Company Ltd., Restructuring of Lanka Mineral Sands Ltd., Technical Core Committee for the National Export Strategy, Family Budget Unit and other national level committees such as National Trade Facilitation Committee (NTFC) and Government Finance Statistics (GFS) Coordinating Committee were the other committees served by ERD staff during the year.

7.4 Statutory Publications and Dissemination of Data and Information

ERD is responsible for releasing statutory publications of the Central Bank and dissemination of data and information in a timely and accurate manner. Accordingly, ERD compiles and publishes two flagship publications annually with the contribution of other departments. As per the provisions stipulated in Section 35 of the MLA, the Annual Report 2016 was published on time, in all three languages. The Annual Report 2016 provided a comprehensive analysis of macroeconomic developments, global economic environment, medium term macroeconomic outlook, and issues and policy responses covering all the sectors of the economy during the year together with the accounts and operations of the Central Bank, major administrative measures and major legislative enactments related to operations of the banking system as well as statistical appendices. In addition, Recent Economic Developments: Highlights of 2017 and Prospects for 2018, was published in all three languages in November 2017, providing a mid-year assessment of the macroeconomic conditions that prevailed during 2017 and the outlook for 2018. For the eleventh consecutive year, ERD assisted the Governor in preparing the policy statement of the Central Bank, Road Map 2018: Monetary and Financial Sector Policies for 2018 and Beyond in December 2017 with inputs received from other departments, which was announced to the public on 03 January 2018. The Road Map was announced with the purpose of sharing the future policy direction and actions of the Central Bank with enhanced transparency and clarity, which would help the stakeholders to design and plan their strategies with more certainty.

Dissemination of economic statistics and information to facilitate diverse range of stakeholders of the economy is one of the primary responsibilities vested with ERD. Accordingly, ERD published the monthly statistical bulletin consisting of data related to all sectors of the economy as well as other economic and financial indicators on daily, weekly, monthly,

quarterly and annual basis on the Central Bank website. ERD continued to provide inputs to monthly and weekly economic indicators during the year while publishing the macroeconomic chart pack, which provides a visual representation of important economic and financial statistics in the three languages. In addition, ERD issued regular press releases on the monetary policy stance of the Central Bank to improve transparency of monetary policy operations, and press releases on external sector performance were issued in a timely manner with the view of communicating latest developments of Sri Lanka's external front. Furthermore, ERD issued press releases on several events in the economy, in the interest of the general public.

7.5 Engaging in Policy Research and Knowledge Sharing

ERD continued to undertake policy research on economic issues of contemporary importance on a regular basis to facilitate proactive decision making on monetary policy by the MPC and the Monetary Board. Accordingly, continuous updates on the state of the domestic and global economy including latest developments and issues in key macroeconomic sectors as well as in capital and financial markets were submitted to the Monetary Board in the form of information series board papers, monetary policy board papers, observation reports and presentations.

The Research Advisory Panel (RAP) of ERD, an internal committee formulated with the aim of fostering the research culture at the Central Bank, continued to provide guidance in research related tasks and knowledge sharing activities throughout the year. "Research in Economics", a short course on research methodology, which was initiated by the RAP in collaboration with CBS during the year was conducted at the CBS, and the RAP members served as the resource personnel of the course. This course has been designed to enhance the research skills of variety of participants from the Central Bank and other academic institutions by providing valuable insights on research methodology. During the year, ERD published Volume 46, No 1 and 2 of 2016 and Volume 47, No 1 of 2017 of the Staff Studies, the research journal of the Central Bank, which included 6 comprehensive research papers completed by officers from ERD and other Departments. In addition, ERD Seminar series was conducted within the department with the view of enhancing and exchanging knowledge on emerging issues in the field of economics. Further, ERD continued to educate groups of interns from numerous universities and higher education institutions who visited the Department during the year, by raising their awareness on practical aspects of Central Banking.

The 10th International Research Conference (IRC) of the Central Bank was successfully organised by the RAP in December 2017. The Conference was organised under the theme of "Macroeconomic Policy Reforms towards a Vibrant Future" with the aim of encouraging innovative theoretical and empirical research on current macroeconomic policy issues, while providing a platform for researchers from policy making

and academic institutions to share their experiences and views from diverse perspectives. The keynote address of the IRC 2017 was delivered by Prof. Keith Houghton, Emeritus Professor of the Australian National University (ANU) on "Evidence Based Public Policy: The Application of Efficiency Measures-The Case of Publicly Funded Australian Universities". As in the past, the 10th IRC attracted eminent researchers from renowned universities, research institutions and central banks around the world including Australia, France, Germany, India as well as Sri Lanka. After a rigorous review process, eight research papers, including three research papers from the officers of the ERD, were selected to be presented at the Conference. At IRC 2017, Dr D. S. Wijesinghe Memorial Award for the Best Research Paper was awarded to Mr. Harsha Paranavithana, a Central Bank officer on study leave, for his paper titled "The Transition from Exchange Rate Targeting: The Case of Sri Lanka". The Conference Proceedings of IRC 2016 was also released at this Conference.

The staff of ERD continued publishing their research in local and international publications. Staff of ERD jointly authored with staff of IMF a paper titled "An Open Economy Quarterly Projection Model for Sri Lanka", which is expected to be published as an IMF working paper. Dr. Chandranath Amarasekara, Additional Director jointly authored a paper titled "Macroeconomic Effects of Monetary Policy Shocks: Evidence from Sri Lanka" that appeared in South Asia Economic Journal in March 2017. In 2017, Dr. Sumila Wanaguru, Deputy Director authored a Chapter titled "Spillover of global liquidity imbalances to currency markets: An emerging economy perspective" which was published in the book titled "Global Liquidity and the Impact on SEACEN Economies", by the SEACEN Centre. A paper titled "Advancement of autoregressive conditional duration models involving liquidity and price dynamics" authored by Dr. Rasika Yatigammana, Deputy Director was published in June 2017 in the Bulletin of the Australian Mathematical Society. ERD officials, including the Director of Economic Research and Additional Directors, served as paper presenters and discussants at various research fora. ERD officers continue to publish articles in periodicals, including the News Survey, the quarterly periodical published by the Central Bank, during the year.

Meanwhile, ERD continued its knowledge sharing efforts towards improving economic literacy of the public in collaboration with the Communications Department (CMD), the Centre for Banking Studies (CBS) and Regional Offices of the Central Bank, for the benefit of university students, school teachers and students, and other government and private institutions. The public lectures on the Annual Report 2016, in all three languages, were conducted by senior officers of ERD. A large number of educational events were conducted by officers of ERD all over the country in the areas of objectives and functions of the Central Bank, monetary policy, fiscal policy, external sector policies and recent economic developments. In addition, ERD officers made presentations on central

banking and macroeconomic developments to both local and foreign delegations who visited the Bank. Also, senior ERD officers assisted internal postgraduate aspirants in developing research skills through the preparation of high-quality research papers and conducting short courses on macroeconomics, microeconomics and mathematics to fulfill the requirements of the postgraduate scholarship scheme of the Central Bank. They also offered prior research consultancy services to junior staff officers and provided need based research supervision to officers in other Departments. At the request of the Training and Development Department, ERD officials evaluated 15 research proposals and 12 completed research papers, in addition to research papers forwarded by the SEACEN Centre. ERD officers also evaluated 70 research proposals received for IRC 2017. Several officers of ERD served as resource persons for the televised educational lecture series, Thakshilawa and Arivootru, conducted in Sinhala and Tamil languages, respectively, organised by the CMD. Department staff also supported the CMD in the organisation of the inter-school quiz competition, Econ Icon held in both Sinhala and Tamil languages. ERD also actively contributed to the organisation of the Inter Bank Quiz Competition of the Institute of Bankers of Sri Lanka.

7.6 Maintaining International Relations

ERD continued to play a key role as the central point of contact for multilateral financial international organisations, such as the IMF, SEACEN, SEANZA, and SAARCFINANCE, on behalf of the Central Bank and the Government of Sri Lanka. ERD further supported the coordination efforts between the Government and World Bank, Asian Development Bank and other major international organisations.

Submission of macroeconomic statistics to various international organisations including the IMF, World Bank and international sovereign rating agencies was continued by ERD in 2017. During the year, ERD coordinated two IMF staff missions related to the IMF-EFF programme together with the annual Article IV Consultation mission. In addition, three IMF Technical Assistance missions related to FPAS were coordinated by ERD. Further, ERD staff liaised with the other Central Banks in the region on several SEACEN events. The chairmanship of the 38th SEACEN Board of Governors (BOG) for 2018 and SEACEN Executive Committee (EXCO) for 2019 was conferred upon the Central Bank of Sri Lanka, at the 37th meeting of SEACEN BOG, held in Bangkok, Thailand. These flagship events to be hosted by the Central Bank of Sri Lanka will be attended by senior officials of 19 SEACEN member Central Banks and the SEACEN Centre. Moreover, the Central Bank of Sri Lanka hosted the 34th SAARCFINANCE Group Meeting in July 2017. This meeting was attended by Governors and Finance Secretaries and other delegates from the Central Banks and Ministries of Finance in the SAARC region. Following

the SAARCFINANCE Group Meeting, the SAARCFINANCE Governors' Symposium, themed "Challenges for the SAARC region amidst Global Uncertainties and Possible Policy Measures to Mitigate these Risks", was held at the John Exter International Conference Hall of the Central Bank of Sri Lanka, with ERD being the organising Department. The Director of ERD presented a country paper which highlighted the impact of global uncertainties on Sri Lankan economy and possible policy measures to mitigate these risks. Moreover, one of ERD officers was a member of the team that conducted the SAARCFINANCE collaborative research study on "Financial Inclusion in the SAARC Region", which was presented at the Symposium and Additional Director of ERD served as the discussant of this research study. ERD continued to submit relevant data on a monthly basis to the SAARCFINANCE database, which was launched in 2016. Furthermore, in 2017, ERD commenced submitting data related to seven vulnerability indicators in SAARCFINANCE database on a quarterly and annual basis. ERD also coordinated the preparation of presentations for various investor fora highlighting recent developments of the economy, trends and movements of key macroeconomic variables and on economic outlook. During the year, ERD also continued to work with international sovereign credit agencies such as Standard & Poor (S&P), Moody's and Fitch, and thereby facilitating sovereign wealth funds, pension funds and other investors to gauge the credit worthiness of Sri Lanka.

8. EMPLOYEES' PROVIDENT FUND

The Employees' Provident Fund (EPF) was established under the Employees' Provident Fund Act No.15 of 1958. In terms of the provisions of the Act all the administrative powers and functions of the Fund are vested with the Commissioner of Labour while all the powers, duties and responsibilities of the fund management are vested with the Monetary Board of the Central Bank of Sri Lanka (CBSL) as the custodian of the Fund. The Monetary Board has empowered the Employees' Provident Fund department of the Central Bank to act as the operational arm in performing its functions.

8.1 Functions of the Department

The EPF department is responsible for the collection of member contributions and surcharges, maintenance of general accounts and member accounts, crediting interest to member accounts, payment of benefits to beneficiaries of the Fund, investment of surplus funds and charging the expenditure incurred by the Monetary Board and Commissioner of Labour in the performance of their duties and functions. The EPF department continued to engage in the above activities as per the policies and directions approved by the Monetary Board in 2017 as well, while maintaining close collaboration with the Commissioner of Labour.

8.2 Performance of the Activities

(a) Value of the Fund, Member Balances and Refunds

The total value of the Fund increased by 12.2 per cent to Rs. 2,066.3 billion as at end 2017 compared to Rs.1,841.5 billion as at end 2016, due to the income generated from investments and net contributions (after deducting refunds from contributions) received. Total liability to the members (member balances) stood at Rs. 2,020.8 billion as at end 2017, recording a 11.6 per cent increase from Rs.1,810.6 billion as at end 2016 (Table II-9). In 2017, total member contribution increased by 12.7 per cent to Rs. 133.3 billion from Rs. 118.3 billion recorded in the previous year, while the total refunds made to the members and their legal heirs in 2017 amounted to Rs. 117.5 billion. Total refunds showed an increase of 8.4 per cent over 2016, as a result of payment under the 30 per cent withdrawal facility for housing and medical requirements. Accordingly, the net contribution increased at a higher rate compared with the previous year to Rs. 15.8 billion, compared to Rs. 9.9 billion recorded in 2016. The net income of the Fund increased to Rs. 202.9 billion in 2017, compared to Rs. 175.9 billion recorded in the previous year, registering a growth of 15.3 per cent.

Table II - 9
Selected Key Information of the Fund

Item	2016	2017(a)	Change (%)
Total value of the Fund (Rs.bn)	1,841.5	2,066.3	12.2
Total liability to members (Rs.bn)	1,810.6	2,020.8	11.6
Total number of member accounts (mn)	17.3	17.3	-
Contributing member accounts (mn)	2.6	2.6	-
Non-contributing member accounts (mn)	14.7	14.7	-
Total contributions (Rs.bn)	118.3	133.3	12.7
Total refunds (Rs. bn)	108.4	117.5	8.4
Net contribution (Rs.bn)	9.9	15.8	59.6
Number of refunds	187,147	260,989	39.5
Net Income (Rs.bn)	175.9	202.9	15.3

(a) Provisional

Source: EPF Department, Central Bank of Sri Lanka

(b) Investment of the Fund and Return

(i) Investment Portfolio:

The total investment portfolio (book value) of the Fund grew by 12.4 per cent to Rs.1,992.4 billion as at end 2017 from Rs. 1,772.2 billion recorded as end 2016 (Table II-10). 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 the Fund and maintaining a sufficient level of liquidity to meet refund payments and other expenses of the Fund.

The investment portfolio consisted of 91.3 per cent in government securities, 4.2 per cent in equity, 2.1 per cent in corporate debentures and trust certificates and the remaining 2.4 per cent in fixed deposits as at end 2017. The maturity profile of the government securities portfolio together with yield rates is given in the Table II-11.

Table II - 10
Investment Portfolio

Type of Investment	2016		2017(a)	
	Amount (Rs.bn)	Share (%)	Amount (Rs.bn)	Share (%)
Treasury Bonds & Bills	1,650.4	93.1	1,818.6	91.3
Equity	80.9	4.6	84.3	4.2
Corporate Debts	38.2	2.1	41.5	2.1
Fixed Deposits	-	-	48.0	2.4
Reverse Repos	2.7	0.2	-	-
Total	1,772.2	100.0	1,992.4	100.0

(a) Provisional

Source: EPF Department, Central Bank of Sri Lanka

Table II - 11
Maturity Profile of Government Securities Portfolio
(As at end of 2017)

Maturity	Maturity Value (Rs.mn)(a)	Share (%)	Weighted Average Yield (%)
Less than 1 year	185,904.1	9.6	10.72
1-2 years	186,896.3	9.7	9.97
3-4 years	157,652.7	8.2	10.82
More than 5 years	1,399,687.6	72.5	11.03
Total	1,930,140.7	100.0	10.88

(a) Provisional

Source: EPF Department, Central Bank of Sri Lanka

(ii) Investment Income:

In 2017, the total investment income of the Fund amounted to Rs. 222.6 billion, recording an increase of 15.4 per cent, compared to that of the previous year (Table II-12). Interest income was the major source of income (84.6 per cent of the investment income) to the Fund and it grew by 13.8 per cent to Rs.188.3 billion in 2017, from Rs. 165.5 billion in 2016. Amortization gains from discounted Treasury Bonds also increased by 11.0 per cent to Rs. 31.3

billion in 2017, from Rs. 28.2 billion in 2016. Further, income realised from equity portfolio, which includes both capital gains and dividends decreased by 36.5 per cent to Rs. 2,993.6 million in 2017, compared to Rs. 4,714.7 million earned in 2016. Due to the temporary suspension of secondary market activities, there was no capital gain on government securities recorded in 2017, compared to that of Rs. 611.8 million in 2016. The impairment of equity investment decreased by 71.3 per cent to Rs. 1,502.1 million in 2017. Overall, return on investments of the Fund has recorded 11.8 per cent in 2017, compared to 11.4 per cent recorded in 2016.

Table II - 12
Income on Investments

Source of Income	2016		2017(a)	
	Amount (Rs.mn)	Share (%)	Amount (Rs.mn)	Share (%)
Interest	165,485.4	85.8	188,346.1	84.6
Amortisation gains	28,170.8	14.6	31,289.3	14.1
Capital gains from government securities	611.8	0.3	-	-
Marked to market gain/loss from government securities	(584.4)	(0.3)	1,640.2	0.7
Marked to market gain/loss from equity	(257.7)	(0.1)	(163.4)	(0.1)
Capital gains from equity	452.1	0.2	-	-
Dividends	4,262.6	2.2	2,993.6	1.3
Impairment of financial assets	(5,231.6)	(2.7)	(1,502.1)	(0.7)
Total	192,909.1	100.0	222,603.7	100.0

(a) Provisional

Source: EPF Department, Central Bank of Sri Lanka

(iii) Expenditure:

The total operational expenditure of the Fund decreased by 9.3 per cent to Rs. 1,348.7 million in 2017, compared to Rs. 1,487.2 million in 2016, and as a ratio of total gross income, it decreased to 0.61 per cent in 2017, compared to 0.77 per cent in 2016 (Table II-13). Over the years, the Fund has maintained its operational expenditure below one per cent of the total gross income.

Table II-13
Operational Expenditure

Item	Amount (Rs.mn)		Change (%)
	2016	2017(a)	
Personnel expenses	861.1	847.3	(1.6)
Administrative expenses	402.8	454.1	12.7
Other expenses	223.3	47.3	(78.8)
Total	1,487.2	1,348.7	(9.3)
Total Expenses as a % of Gross Revenue	0.77	0.61	

(a) Provisional

Source: EPF Department, Central Bank of Sri Lanka

(c) Payment of Interest on Member Balances

Over the last 10 years, EPF was able to pay a consistently high rate of interest to members over and above its statutory minimum rate of 2.5 per cent (Table II-15). A sum of Rs.

198.5 billion was available for distribution as interest to the members of the Fund as at end 2017, compared to Rs. 171.5 billion in 2016 (Table II-14). Accordingly, EPF was able to pay an interest rate of 10.5 per cent on member balance for 2017, exceeding the budgeted rate of 10.0 per cent.

Table II-14
Payment of Interest to Members

Item	Amount (Rs.mn)		Change (%)
	2016	2017(a)	
Gross revenue	193,071.4	223,192.5	15.6
Total operating expenses	(1,487.2)	(1,348.7)	(9.3)
Income tax	(15,657.2)	(18,897.1)	20.7
Net income for the year	175,927.0	202,946.8	15.4
Prior year retained profit	215.6	189.3	(12.2)
Interest paid on current year refunds	(4,645.8)	(4,624.3)	(0.5)
Net income available for distribution (after payment of interest on current year refunds)	171,496.8	198,511.8	15.8
Transfers from/(to) reserves	250.0	(7,000.0)	(2,900.0)
Net income available for distribution after transferring from / (to) reserves	171,746.8	191,511.8	11.5
Interest paid on member balances	(171,557.4)	(191,243.8)	11.5
Retained profit	189.4	268.0	41.5
Interest rate paid on member balances %	10.5	10.5	-

(a) Provisional

Source: EPF Department, Central Bank of Sri Lanka

Table II - 15
Rate of Interest paid on Member Balances

Year	Interest Rate Paid (%)	Effective Interest Rate (%) ¹
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	11.50	11.62
2013	11.00	11.14
2014	10.50	10.60
2015	10.50	10.57
2016	10.50	10.51
2017 (a)	10.50	10.51

(a) Provisional

Source: EPF Department, Central Bank of Sri Lanka

¹ EIR = (Interest paid to members) / [(Beginning of the year member balances + year end member balances before crediting interest) / 2]

(d) Risk Management

The Central Bank and EPF department have taken several measures to strengthen the risk management and internal controls to mitigate financial as well as non-financial risks of the Fund. Segregation of duties and other internal controls, including a voice recording system, have been introduced during the year 2017.

(e) System Development

EPF is in the process of reviewing and restructuring its investment strategy and framework with the technical

assistance of World Bank (WB) under the Financial Sector Modernization Project. Furthermore, WB is providing financial assistance for the implementation of a comprehensive ICT solution for EPF. In view of this, a Business Process Review (BPR) is being conducted with the technical assistance of Asian Development Bank (ADB), under the Capital Market Development Programme.

8.3 Member Services

(a) Member Account Statements

Member account statements are being issued to the active members of EPF, through their employers. 2016 1st half and 2nd half statements were dispatched to the relevant employers during 2017. The first half of 2017 will be commenced in end March 2018.

Table II - 16
No. of Member Statements Issued

Half	No. of Employers	No. of Statements (Active Members)
2016 1 st half	71,310	2,141,812
2016 2 nd half	73,076	2,568,104

Source : EPF Department, Central Bank of Sri Lanka

(b) Housing Loan Facility

The Housing Loan Scheme, which was introduced in 1988 with the objective of facilitating the members to obtain housing loans from the participating lending institutions, viz., Housing Development and Finance Corporation Bank, State Mortgage and Investment Bank, Bank of Ceylon, People's Bank and Co-operative Rural Banks, continued in 2017 providing an essential service to the EPF members. Under this scheme, 10,998 guarantee certificates were issued by EPF to members against their EPF balances to participating lending institutions for the approval of housing loans amounting to Rs.4,946 million (Table II – 17). Further, nearly Rs. 2,485 million was deducted from the relevant member accounts and was remitted to the participating lending institutions in 2017 to settle the loans in arrears during the year 2016.

Table II-17
Housing Loan Facility

Year	Issued Certificates (No.)	Credit Approved (Rs. mn)	Amount Remitted to Lending Institutions (Rs. mn)
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	11,234	3,973	2,019
2013	16,268	6,914	2,178
2014	17,786	8,021	2,394
2015	13,132	5,489	2,522
2016	12,780	5,414	2,541
2017(a)	10,998	4,946	2,485

(a) Provisional

Source: EPF Department, Central Bank of Sri Lanka

(c) Pre-Retirement Refund Scheme

In terms of the provisions in Employees Provident Fund (Amendment) Act, No. 02 of 2012 and the subsequent procedures passed by the Parliament, payments under the 30 per cent EPF pre-retirement refund scheme has been in operation since 01st July 2015. The scheme is in high demand by beneficiaries and Rs. 58.3 billion has been refunded to over 100,000 beneficiaries by the end of 2017 since the inception of the scheme. During 2017, Rs.17.29 billion has been released to 32,789 beneficiaries under this scheme.

(d) Image Scanning Project

The Image Scanning Project (ISP) was implemented with a view to improving the efficiency of services provided by EPF department by establishing a near-paperless operating system.

With the completion of Phase-I of the project, the traditional model of the EPF record room was converted into an e-Record room. All the Master File records, Form D and re-registration documents have been scanned, indexed and uploaded to the Document Management System. The document retrieval, file updating, notifications and all other related functions have been made available for the departmental users at their own desktop. Most of the manual processes have been automated minimising the involvement of staff members. This transformation has resulted in a considerable saving of time, space and human resources.

Based on the process efficiencies gained through phase-I, the phase-II of the project was initiated at the end of the year 2016 to digitize the other frequently used records. The digitization of documents at the phase-II includes: The Form C and C3 used for the collection of contribution from employers belonging to the years 2013, 2014 and 2015, Refund worksheets from 2002 to 2015 except for the year 2013; Individual Employer Ledgers (IEL) for the period 1974 to 2009; amendment letters from 2010 onwards and re-registration documents belonging to the year 2014. The above scope of the project was completed during the year 2017.

Refund payment and part payment processes were made efficient now as all correspondences related to payment from 2001 is scanned and uploaded to the system. Also other member services such as name amendment and re-registered member detail amendments are also being made efficient.

At the end of year 2017, the scope of the phase-II of the project was extended to include the scanning and indexing of Form C and C3 belonging to the years 2016 and 2017.

(e) EPF Mobile Service Programme

EPF mobile service in the year 2017 was conducted with a view to enhancing the delivery of member services at their convenience and enhancing public awareness on EPF operations.

Accordingly, during the year the Department conducted 22 mobile services. Some of these mobile services were conducted in collaboration with the Department of Labour, Department of Registration of Persons, Registrar General's Department and respective District/Divisional Secretariats.

EPF department also participated in mobile services related to EPF, organized by the government and non-government organizations to provide EPF related services. Mobile services offered almost all the services a member could obtain by visiting the EPF Department located in Colombo, at their own area or work place. The services offered to the members and public through the awareness programmes included: Issuing of EPF member balance statements, amendment of EPF member details and accounts, re-registration of member details, promoting online member balance inquiry service and e-return services and providing advice on overall EPF procedures.

In addition, awareness activities were conducted parallel to the mobile services, targeting members, employers and other stakeholders on the services offered by the EPF using various modes of communication such as e-mail, posters, leaflets, video clips and presentations.

Prior to each mobile service, a special awareness programme is conducted for relevant employers, managers and other administrative staff members of respective employers with a view to enhancing the effectiveness of the mobile services.

(f) e-Return System for EPF Payments

Collection of EPF contributions and respective member details by electronic means (e>Returns) was introduced to the registered employers thereby increasing the EPF's operational efficiency and transparency. This procedure was initiated on a voluntary basis and made mandatory in 2012 for employers with over fifty employments. Actions were taken to enhance the accessibility of employers to the e-Return submission procedure in 2017. As a result, wider discussions were carried out by EPF with Licenced Commercial Bank of Sri Lanka (LCBs) during the year and it has helped to obtain the service of one more LCB from January, 2018. Accordingly, seven LCBs have already joined EPF as collecting agents and three LCBs among them facilitate their online EPF paying customers (employers) with member information validation and real time member accounts updating procedure. In addition, actions were taken to make the employers further aware of the e-Return submission procedure and it benefits for EPF stakeholders. Accordingly, the participation of employers for e-Return submission procedure increased from 6,955 to 7,900 in 2017 covering approximately 65 per cent of the active member accounts representing nearly 80 per cent of the total monthly EPF contributions.

(g) Re-registration of EPF Members

With the intention of providing an efficient service to EPF members, EPF department and the Department of Labour launched a special project to re-register EPF members by

names as appearing in their National Identity Card (NIC) and assign NIC number as the Unique Identification (UID) Number, which enables both parties to use a common Member Centric Database (MCD).

By end 2017, the NIC details of approximately 1.86 million active EPF members (contributing members) had been collected. Out of these, 81 per cent of the member accounts (1.51 million accounts) were assigned UIDs, while the verification of details of the remaining members are being processed.

Registering of new EPF members under NIC details on real time basis commenced in November 2010. Accordingly, a monthly monitoring system has been put in place to capture NIC details of all new members whose member contributions are received for the first time.

Registration of existing members and registration of new members amounted to 53,091 and total number of registrations transferred to the MCD was 71,234 by end 2017.

9. EXCHANGE CONTROL/ FOREIGN EXCHANGE

Exchange Control Department (ECD) established for the purposes of carrying out the provisions of the Exchange Control Act, No. 24 of 1953 (ECA) which governed foreign exchange transactions, exercised and performed powers, duties and functions under the ECA until 19 November 2017.

With a view to further liberalizing capital flows, simplifying the processes associated with foreign exchange transactions and keeping with the announcement made by the government in its Budget Proposals for 2016 and 2017, a new legislative and policy framework for foreign exchange operations was introduced during 2017.

Accordingly, the Foreign Exchange Act, No. 12 of 2017 (FEA), which provides for the promotion and regulation of foreign exchange by vesting such responsibility in the Central Bank as the agent of the Government of Sri Lanka, came into effect from 20 November 2017. Provisions of the new Act are implemented through the newly established Department of Foreign Exchange (DFE), headed by the Director of Foreign Exchange and the functions of ECD ceased on 19 November 2017 by operation of law.

Paragraph 9.1 of this note specifies activities undertaken by ECD until 19 November 2017 under ECA and paragraph 9.2 specifies functions performed by DFE in terms of FEA.

9.1 Exchange Control

The main functions and the activities performed under ECA during 2017 are summarised below.

9.1.1 Granting General Permission for Foreign Exchange Transactions

- (a) Issuance of Directions to Authorized Dealers (ADs) i.e., Licenced Commercial Banks (LCBs), National Savings Bank (NSB) and other entities dealing in foreign exchange.

Directions issued to ADs under ECA during 2017 are given in Part III of this Report and a summary is given below.

- i) Directions No. 01 and 02 of 2017: ADs were permitted to grant loans to Sri Lankans resident outside Sri Lanka on Permanent Residency (PR) visa and dual citizenship.
- ii) Directions No. 03, 04, 05 and 06 of 2017: Directions were issued to NSB on Non Resident Foreign Currency (NRFC) Accounts, Resident Foreign Currency (RFC) Accounts, Resident Non-Nationals' Foreign Currency (RNNFC) Accounts and Foreign Exchange Earners' Accounts (FEEAs), permitting to operate such accounts in line with the Directions issued to ADs.
- iii) Directions No. 07 of 2017: The opening of new Foreign Currency Accounts for International Services Providers & their Employees by ADs were withdrawn in the absence of the income tax exemptions granted to the professional service providers who are involve in the 'Exempt Projects' under the provisions of the Inland Revenue Act.
- iv) Directions No. 08, 09, 10, 11, 12 and 13 of 2017: LOLC Finance PLC, People's Leasing and Finance PLC and LB Finance PLC were issued Directions in line with the Directions issued to ADs on NRFC and RFC accounts.
- v) Directions No. 14 and 15 of 2017: Melsta Regal Finance Ltd was permitted to open NRFC and RFC Accounts for eligible persons.

9.1.2 Granting Special Permission for Foreign Exchange Transactions

- (a) Special permissions were granted under ECA for the specific purposes illustrated in Table II - 18.

Table II - 18
Special permissions granted for foreign exchange transactions under ECA

Purpose	No. of approvals	Value in USD million
Resident companies to invest abroad	9	23.10
Resident companies to borrow from abroad	19	177.7
Companies to issue/register/transfer of shares and individuals to transfer of shares in the name of non-residents	78	N/A
ADs to engage in miscellaneous transactions that are not covered under Directions issued to ADs	58	N/A
ADs to open and maintain Special Foreign Currency Accounts	10	N/A
Resident companies to issue corporate guarantees	15	83.12

- (b) Issuing Permits to engage in money changing business

Up to 19 November 2017, five companies were issued new permits to engage in money changing business as follows, while one company withdrew from money changing business. Accordingly, there were 70 companies

engaged in money changing business, i.e., 57 permitted only to buy foreign currencies and 13 permitted to buy and sell foreign currencies. Approval was also granted to an existing money changer to open a new branch during 2017.

Table II - 19
Permits issued to companies to engage in money changing business

Category of the institution	Permitted businesses	No. of permits issued
Limited liability companies who are to solely engaged in the money changing business (money changers)	Buying and exchanging foreign currency	3
	Buying, exchanging and selling foreign currency	-
Licensed Finance Companies (LFCs)	Buying, exchanging and selling foreign currency	-
Specialized Leasing Companies (SLCs)	Buying, exchanging and selling foreign currency	1
Tourist Hotels	Buying foreign currency	1
Total		5

9.1.3 Facilitating the Implementation of the New Foreign Exchange Management Framework

- (a) Provision of observations on the Foreign Exchange Bill (FEB)

ECD with the collaboration of the Legal and Compliance Department provided observations on the FEB several times, considering potential impacts of the proposed policies on the foreign exchange market and operational aspects for easy implementation.

- (b) Formulation of Regulations, Orders & Directions to implement provisions of FEA

Upon the Hon. Speaker certifying the FEA on 28 July 2017, ECD engaged in formulation of regulations and orders to be issued by the Minister under FEA. Such regulations were published in the Government Gazette Notifications on 17 November 2017. FEA came into operation on 20 November 2017. Regulations and orders under FEA are given in Part III of this Report and a summary is given in paragraph 9.2 of this note.

9.1.4 Transfer of Migrants' Funds

ADs were permitted to open 108 Migrant Blocked Accounts in order to release migration allowance to Sri Lankans who had obtained Permanent Residency (PR) in another country after 12 June 2013. Further, 207 Sri Lankan migrants who had obtained PR in another country on or before 12 June 2013 were permitted to remit funds outside Sri Lanka through Non Resident Blocked Accounts.

9.1.5 Monitoring and Surveillance/Investigations of Foreign Exchange Transactions

(a) On-site Inspections

32 on-site inspections were conducted in order to assess the status of compliance of ADs with the Directions and other requirements stipulated by ECD with regard to foreign exchange operations and another 31 on-site inspections were conducted in order to ascertain the status of compliance of money changers with terms and conditions of permits issued to them.

(b) Investigations

244 investigations were carried out under the provisions of ECA. After concluding 45 investigations, Rs. 82.33 million was transferred to the Consolidated Fund being penalties imposed against relevant parties of such investigations. The balance 199 investigations are expected to be completed before 20th May 2018 in terms of Section 30(2)(b) of FEA. Majority of these investigations were on non-compliance of issuing and transferring of securities/shares contravening the procedure set out in general permissions, unauthorized payments made by residents to non-residents, non-compliance by ADs with Directions/Operating Instructions issued by CE, violation of conditions in permits issued to Authorized Money Changers and unauthorized possession of foreign currencies.

(c) Law enforcement authorities were further assisted in litigation and juridical proceedings by providing expert evidences/testimonies.

9.1.6 Enhancing Awareness on Exchange Control Regulations

Five interactive meetings were conducted for the purpose of ensuring that ADs were updated on current regulations and obtaining and evaluating their suggestions on proposed new regulations. Further, four programmes were conducted in outstations such as Badulla, Nuwara Eliya, Matara and Ampara with a view to bridge the knowledge gap of the stakeholders on foreign exchange regulations.

9.2 Foreign Exchange

The new foreign exchange law was implemented by repealing ECA, with a view to achieving greater efficiency and effectiveness in the conduct of international financial transactions and facilitating economic activities at a macro level to address the prevailing perception that capital flows to and from the country are quite restrictive.

The new regulations focus on facilitating foreign exchange transactions rather than controlling so as to meet expectations of the stakeholders and potential investors through reducing restrictions, excluding ambiguities, simplifying processes associated with transactions and enhancing efficiency in the conduct of foreign exchange transactions.

Accordingly, the major functions of DFE are granting authorizations/permissions to ADs and Restricted Dealers (RDs), issuing Directions and guidelines to ADs and RDs, facilitating the issue of Gazette Notifications to the general public, granting approvals for specific foreign exchange transactions, considering the appeals made against decisions of ADs/RDs, monitoring and investigating foreign exchange, enhancing awareness and capacity building of ADs, RDs and other stakeholders on applicable regulations.

The main functions and the activities performed by DFE are summarised below.

9.2.1 Granting of Authorisation/Permission to ADs/RDs

In terms of FEA, every LCB and NSB (to the extent of permission) were authorised to act as ADs. Money changers, hotels, LFCs, etc. were also authorised to deal in foreign exchange as RDs. Accordingly, as at 31 December 2017 there were 26 ADs and 70 RDs and their names are given in Annex II-2.

9.2.2 Granting General Permission for Foreign Exchange Transactions

(a) Issuance of Gazette Notifications facilitated by DFE

Regulations made by the Minister under Section 29 read with Sections 5, 7 and 8 of FEA and Orders issued under Sections 8 and 31 of FEA published in the Government Gazette No. 2045/56 dated 17 November 2017, appear in Part III of the Annual Report. The major changes introduced through these regulations/orders are summarized below.

- i) Foreign Exchange (Capital Transactions in Foreign Exchange carried out by ADs) Regulations No. 1 of 2017
 - Enhanced the limits prevailing on overseas investments made by residents in Sri Lanka and expanded the categories available for such investments (from shares and Sovereign Bonds to units and debt securities as well), creating more investment opportunities.
 - Permitted ADs to transfer eligible migration allowances through Capital Transactions Rupee Accounts (CTRAs) maintained with ADs upon submitting the relevant documents and enhanced the limits that prevailed on migrant transfers, facilitating migrants to settle in other countries.
 - Broadened the areas available for non-residents for investments in Sri Lanka by including fixed deposits in financial institutions, securities issued by the Central Bank or any other statutory body, shares in companies not incorporated in Sri Lanka and listed in the Colombo Stock Exchange, while creating new opportunities and enhancing availability of investment avenues for prospective investors.

- A single scheme of loans for Sri Lankans employed abroad was introduced by amalgamating previously prevailing three types of loan schemes, to simplify applicable regulations.
 - ii) Foreign Exchange (Opening and Maintenance of Accounts for the purpose of engaging in Capital Transactions) Regulations No. 2 of 2017 and Foreign Exchange (Opening and Maintenance of Foreign Exchange Accounts) Regulations No. 3 of 2017
 - Classified eighteen accounts that had been permitted under ECA, into five main categories named Personal Foreign Currency Accounts (PFCAs), Business Foreign Currency Accounts (BFCAs), Inward Investment Accounts (IIAs), Capital Transactions Rupee Accounts (CTRAs) and Outward Investment Accounts (OIAs) ensuring clarity and convenience in foreign exchange transactions.
 - iii) Order under Section 8
Enhanced the declaration limit of carrying foreign currency notes up to the value of US dollars 10,000 or its equivalent, by persons arriving in Sri Lanka and intends to take back such currencies, following the international norms. Further, any person in or resident in Sri Lanka was permitted to retain in his possession foreign currency notes up to the value of US dollars 10,000 or its equivalent for any period subject to the conditions given in the Order.
 - iv) Order under Section 31
A new criterion for determining a person's residential status was introduced based on the aggregate number of days spent in Sri Lanka (i.e. 183 days or more), rather than focusing on the permanent place of abode, as required under ECA.
- (b) Issuance of Directions to ADs
- Directions issued to ADs under FEA are given in Part III of this Report and a summary is given below.
- i) Directions No. 01 of 2017: ADs were permitted to carry out current transactions subject to the terms and conditions specified in the Directions.
 - ii) Directions No. 02 of 2017: ADs were permitted to issue credit cards to foreign citizens who held diplomatic passports and diplomatic identity cards and residents outside Sri Lanka up to a limit of 90% of funds available in their foreign currency accounts in Sri Lanka held as collateral.
 - iii) Directions Nos. 03, 04, 05, 08 of 2017: ADs and RDs were informed about the terms and conditions applicable to PFCAs, BFCAs, Diplomatic Foreign Currency Accounts & Diplomatic Rupee Accounts, and CTRAs in addition to those specified in the regulations.
 - iv) Directions No. 06 of 2017: ADs were permitted to open Resident Guest Foreign Currency Accounts and Resident Guest Rupee Current Accounts in favour of prospective investors and professionals who come to Sri Lanka under the Resident Guest Scheme.
 - v) Directions No. 07 of 2017: ADs were permitted to open Senior Foreign Nationals' Fixed Deposit Accounts and Senior Foreign Nationals' Rupee Accounts in favour of senior foreign nationals who obtain resident visa in Sri Lanka under "Sri Lanka – My Dream Home" Programme.
 - vi) Directions No. 09 of 2017: ADs were permitted to grant loans in foreign currency to persons in Sri Lanka who maintain BFCAs.
 - vii) Directions No. 10 of 2017: ADs were permitted to grant loans and advances to Sri Lankans employed abroad to be utilized for any purpose in Sri Lanka.
 - viii) Directions No. 11 of 2017: ADs were permitted to grant loans to Sri Lankans resident outside Sri Lanka on PR in another country and dual citizens, irrespective of their residential status, for the purpose of acquiring/constructing/developing/renovating a residential property in Sri Lanka.
 - ix) Directions No. 12 of 2017: ADs and Primary Dealers appointed as designated agents for purchasing and marketing Sri Lanka Development Bonds (SLDBs) were permitted to maintain 'Sri Lanka Development Bonds Investment Accounts' and 'Dollar Accounts for Bond Investment' for the purpose of acquiring, holding and transferring SLDBs.
 - x) Directions No. 13 of 2017: ADs were permitted to open and maintain IIAs and applicable terms and conditions in addition to those specified in the regulations were informed.
 - xi) Directions No. 14 of 2017: ADs were permitted to open and maintain OIAs and applicable terms and conditions in addition to those specified in the regulations were informed.
 - xii) Directions No. 15 of 2017: ADs were permitted to issue and renew bank guarantees, bonds, standby letters of credit and make payments in relation to corporate guarantees.
- 9.2.3 Granting of Special Permission for Foreign Exchange Transactions**
- Special permissions were granted under FEA for the specific purposes illustrated in Table II - 20.

Table II - 20
Special Permissions granted under FEA

Purpose	No. of approvals	Value in USD million
Resident companies to invest abroad	1	30
ADs to open and maintain Special Foreign Currency Accounts	3	N/A

9.2.4 Transfer of Migrants' Funds

ADs were permitted to open 148 CTRAs in order to release the migration allowance to Sri Lankan migrants and inherited funds to non-nationals.

9.2.5 Enhancing Awareness on Foreign Exchange Regulations

Awareness programmes were conducted at the Centre for Banking Studies of the Central Bank of Sri Lanka for the purpose of educating the bankers and the general public on the new foreign exchange management framework. In addition, the official website of the DFE, www.dfe.lk was launched to enhance the awareness of the general public and other interested parties on the new foreign exchange regime.

Annex II-2
List of Authorized Dealers (ADs) as at 31.12.2017

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

List of Restricted Dealers (RDs) as at 31.12.2017

Licensed Finance Companies	
1	Asia Asset Finance PLC
2	Bimputh Finance PLC
3	Citizens Development Business Finance PLC
4	LOLC Finance PLC
5	L B Finance PLC
6	Senkadagala Finance PLC
7	Sinhaputhra Finance PLC
8	Singer Finance (Lanka) PLC
Specialized Leasing Companies	
9	SMB Leasing PLC
Tourist Hotels	
10	Pearl City Hotel
11	Shangri-La's Hambantota Resort & Spa
12	Sigiriya Jungles
Money Changers	
13	A.O.Lakshmi Jewels (Pvt) Ltd
14	Abdeen Money Changers (Pvt) Ltd
15	Ariyawansa Enterprises (Pvt) Ltd
16	Arrujina Jewellery (Pvt) Ltd
17	Aruna Forexc (Pvt) Ltd
18	Asian Money Exchange (Pvt) Ltd
19	Brescia Grameen (Pvt) Ltd
20	Bullion Money Exchange (Pvt) Ltd
21	Capital Exchange (Pvt) Ltd
22	City Exchange (Pvt) Ltd
23	Colombo Money Exchange (Pvt) Ltd
24	Crown Money Exchange (Pvt) Ltd
25	Dadigama Group (Pvt) Ltd
26	Data Exchange International (Pvt) Ltd
27	Daya Authorized Money Changer (Pvt) Ltd
28	Delta Sarath Holdings (Pvt) Ltd
29	Devi Forex (Pvt) Ltd
30	George Michael Holdings (Pvt) Ltd
31	Global Village Exchange (Pvt) Ltd
32	Golden Money Changers (Pvt) Ltd
33	International Exchange (Pvt) Ltd
34	Jayes Investments Ltd
35	Jewel Lanka Money Exchange (Pvt) Ltd
36	Kamal Enterprises (Pvt) Ltd
37	Keyser Exchange (Pvt) Ltd
38	Kudamadu Money Exchange (Pvt) Ltd
39	M.P. Money Changer (Pvt) Ltd
40	Majestic Jewellery (Pvt) Ltd
41	Maruthi Money Exchange (Pvt) Ltd
42	Mayurie Money Changers (Pvt) Ltd
43	Metro Forex (Pvt) Ltd

44	Midna Mini Market (Pvt) Ltd
45	Milano Money Exchange (Pvt) Ltd
46	Monte Carlo Exchange (Pvt) Ltd
47	Narmatha Gold Centre (Pvt) Ltd
48	New Natasha (Pvt) Ltd
49	New Regal's Money Changer (Pvt) Ltd
50	Pathfinder (Pvt) Ltd
51	Pearl Exci (Pvt) Ltd
52	Prasanna Money Exchange (Pvt) Ltd
53	Pushpa Money Changer (Pvt) Ltd
54	Rafeek's Gems (Pvt) Ltd
55	Ravi Forexae (Pvt) Ltd
56	Rimha Jewellery (Pvt) Ltd
57	Rivindu Enterprises (Pvt) Ltd
58	Red Ruby Jewellers (Pvt) Ltd
59	Royal Money Exchange (Pvt) Ltd
60	Royal Money Mart (Pvt) Ltd
61	Salaka Trust Investment (Pvt) Ltd
62	Sharanga Money Exchange (Pvt) Ltd
63	Shifaz Money Exchange (Pvt) Ltd
64	S S D D Money Exchanging (Pvt) Ltd
65	Swiss Money Exchange (Pvt) Ltd
66	Thomas Cook Lanka (Pvt) Ltd
67	Unic Forex (Pvt) Ltd
68	Vasanthas Intl. Money Exchange (Pvt) Ltd
69	Western Money Exchange (Pvt) Ltd
70	Windsor Money Exchange (Pvt) Ltd

10. FACILITIES MANAGEMENT

The Facilities Management Department (FMD), initiated the Central Bank Head Office Retrofit Project in 2017 with a view to ensure improved working conditions for the Central Bank employees/stake holders. Under the project, emphasis was placed on enhancing the reliability of electrical and mechanical services and the structural soundness of the Central Bank Head Office building.

During the year, measures were taken to ensure reliability and efficiency of the vital building amenities, ensuing an apt working atmosphere for the Central Bank employees to carry out their work without any hindrance. Regular inspections were carried out to ensure the proper functionality of critical services. Further, the preliminary work on upgrading and expanding the CCTV coverage at the Central Bank Head Office building was initiated for better surveillance and monitoring.

A major policy decision was taken on rented out Central Bank properties/buildings in compliance with MLA and consequently, all the local tenants were informed of the MB decision to vacate all Central Bank properties by end of 2019.

Several construction and maintenance projects, including the renovation of the Somawathiya holiday home and Regional Offices of Kilinochchi, Matara and Matale were completed within the stipulated time and costs with the required quality standards. Some of the basic requirements of Sovereign residencies were also completed.

The transport facilities were enhanced with the addition of six (06) new vehicles to the Central Bank vehicle fleet while action was initiated to dispose eleven (11) uneconomical vehicles purchased at least a decade ago. To increase the availability, reliability and the cost effectiveness of the transportation facilities, FMD secured the services of several outsourced vehicle service providers capable of providing efficient transport service with the latest facilities including online billing and tracking of vehicle movements for the year 2018.

Further, FMD was able to provide efficient and timely transport facilities for over 400 foreign delegates with the support of external service providers during the Asia/Pacific Group on Money Laundering meeting held during July 2017.

The FMD continued to provide holiday home facilities with a streamlined process to improve the convenience of Central Bank employees and pensioners. The annual user satisfaction survey was conducted in Q3 -2017 and necessary measures were taken to enhance user contentment.

11. FINANCE

The Finance Department (FD) undertakes the financial reporting function of the Central Bank of Sri Lanka, in terms of International Accounting Standards / International Financial Reporting Standards and relevant provisions of the Monetary Law Act (MLA). Functions of the FD include preparation of the financial statements of the Central Bank, preparation and monitoring of the annual budget of the Central Bank, maintaining a payment system for internal and external financial transactions of the Central Bank, disbursement of donor funds & repayment of foreign loans of the government, maintaining systems for internal reporting of financial transactions, management of 17 internal funds, maintaining the Fixed Assets Register for the Central Bank and maintaining the database of staff loans.

11.1 Preparation of the financial statements

- (a) **Monthly Balance Sheet:** As per the requirement of the Monetary Law Act, the monthly Balance Sheets for December 2016 and January to November 2017 were prepared.
- (b) **Quarterly Reports:** Quarterly financial performance and positions were reported to the Monetary Board in the year 2017.
- (c) **Annual Financial Statements:** Since 2002, International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS) have

been adopted. Financial statements are published in the Annual Report of the Central Bank. Accounting systems and procedures were updated to comply with relevant accounting standards and requirements on a continuous basis during the year 2017. Audited Financial Statements of the Central Bank for the year 2017 are presented at the beginning of Part II of the Annual Report.

(d) Preparation For IFRS 9: During 2017 following steps have been carried out with regard to the successful implementation of IFRS 9 with effect from the year 2018.

- i. Held several awareness sessions for the senior management and staff in the related departments.
- ii. Obtained technical assistance from an Audit firm.
- iii. Assessed the asset classification and decided on the impairment model.
- iv. Obtained clearance from the external auditor appointed by the Auditor General.
- v. Discussed with the Advisory Audit Committee and obtained the approval of the Monetary Board for the methodologies.
- vi. Required changes to accounting and treasury systems with regard to asset classification have been tested and implemented and further changes to the accounting process will be carried out in due course, as required.

11.2 Preparation of the Annual Budget

The annual income and expenditure budget and capital budget of the Central Bank for the year 2018 were prepared in line with action plans under the strategic plan of each department of the Central Bank. This process started in August 2017 and finalised in November 2017. The approval of the Monetary Board for the budget of the Central Bank was obtained in November 2017 and the budget was made available to the departments on the first working day of 2018. Quarterly budgetary performance statements for the year 2017 were submitted to 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 2017 within the time targets.
- (b) All external payments to local and foreign suppliers were made as per the procedures laid down under the standing orders of the Central Bank. During the year 2017, the total number of payments were 4,978, which included 4,722 to local suppliers and 256 to foreign suppliers.

- (c) Nearly 2,776 disbursements amounting to Rs 1,103.9 bn to the General Treasury and relevant projects and 617 installments amounting to Rs 727.6 bn on repayment of foreign loans were made during the year 2017. In addition, 9 banking arrangements were signed with a foreign bank for various projects.

11.4 Management of internal funds

- (a) A separate unit was established under the FD and commenced operations in March 2016 to centrally manage the investments of the Central Bank's internal funds (Excluding EPF) as per the decision taken by the Monetary Board. Accordingly, FD manages 17 internal funds consisting of 8 superannuation funds of the staff and pensioners and 4 other funds administered by the FD, Deposit Insurance and Liquidity Support Fund administered by the Bank Supervision Department, 3 funds administered by the Staff Services Management Department and project funds administered by the Regional Development Department. All funds are invested under a Common Investment Policy by the FD and the respective owner departments perform as the administrators of their funds. Fund Management governance system includes an independently operating front office, middle office and a back office and decisions taken at the Investment Committee (IC), chaired by a Deputy Governor, which met 12 times during the year 2017, to advise and monitor the investments of funds. Investments were reported monthly to the Monetary Board for ratification.
- (b) The funds are invested mainly in Government Securities, Fixed Deposits in State Banks (Bank of Ceylon, National Savings Bank and People's Bank), high rated corporate debentures and Short Term Reverse Repos. The audited financial Statements of five superannuation funds for 2016 were submitted to the Monetary Board as per the rules of those funds. As at end 2017, total fund base increased to Rs.93.88 bn.

Table II - 21
Performance of Funds Management - 2017

Department	Rs. bn	
	Portfolio value as at 31st Dec 2017 (invested values)	Portfolio value as at 31st Dec 2016 (invested values)
Finance	52.22	48.90
Bank Supervision	38.47	27.21
Regional Development	3.12	3.09
Staff Services Management	0.07	0.06
Total	93.88	79.26

11.5 Maintaining Fixed Assets Register

The FD maintained all records of the fixed assets of the Central Bank in the Fixed Assets Register in the fixed asset module of the General Ledger System. All changes such

as new purchases and locations, change of locations, revaluations, depreciation and disposals were recorded in this register during the year 2017. The register was updated during the year 2017 with 760 items procured and 423 disposals.

11.6 Maintaining the data base of staff loans

The FD continuously maintained the loan database of the Central Bank staff with the assistance of the Information Technology Department to facilitate the loan recovery record process and to supply information to employees and to the Management during the year 2017. 942 number of loans amounting to Rs 1.08 bn have been granted to the employees during 2017.

11.7 Other Operations - Procurement Process

According to the rules of the Central Bank, the FD is represented in all Technical Evaluation Committees and Tender Boards for procurement of goods and services and the Board of Survey of the Bank. During the year 2017, FD officers represented the Department in nearly 151 Tender Boards and 45 Technical Evaluation Committees related to procurements.

12. FINANCIAL INTELLIGENCE UNIT

Financial Intelligence Unit (FIU) was established in 2006 under the Financial Transactions Reporting Act, No. 6 of 2006 (FTRA) as an independent statutory authority. The FIU, for administrative purposes, has been functioning as a Department within the Central Bank since March 2007, in terms of an order made by the Minister of Finance under the FTRA. 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) and Terrorist Financing (TF) and other related unlawful activities defined in the FTRA, analysis of suspicious financial transactions relating to above mentioned unlawful activities and dissemination of information of such analyses to relevant law enforcement authorities for investigation. Furthermore, the functions of the FIU are also enforced under the Prevention of Money Laundering Act, No. 5 of 2006 (PMLA) and Convention on the Suppression of Terrorist Financing Act, No. 25 of 2005 (CSTFA).

12.1 Receipt, Analysis and Dissemination of Information

FIU receives information on financial transactions, including suspicious transactions from reporting institutions through a web-based system, "LankaFin", especially designed to assist in reporting on ML and TF. Licensed Commercial Banks (LCBs), Licensed Specialised Banks (LSBs), Licensed Finance Companies (LFCs), Insurance Companies, Stock Brokers (SBs) and Money or Value Transfer Service (MVTS) providers continued to report to the FIU on cash transactions and electronic funds transfers (both local and foreign) of Rs. 1.0 million and above each or its equivalent in foreign currencies. In addition, Suspicious Transactions Reports (STRs) were filed with the FIU by the Reporting Institutions in terms of Section

7 of the FTRA. Accordingly, over 9.27 million of cash/funds transfers and 925 STRs were reported during the year 2017. Moreover, Authorised Money Changers (AMCs) also reported their cash transactions exceeding the threshold amount through the Controller of Exchange who monitors and regulates the AMC sector. In 2017, the FIU disseminated 418 STRs to law enforcement and regulatory authorities for further investigation.

12.2 Regulation of Reporting Institutions

Extraordinary Gazette Notification No. 2015/56 dated 30 March 2017 on Suspicious Transactions (Format) Regulations of 2017 was issued prescribing the obligation to report any transactions that maybe related to commission of any unlawful activity/criminal offence. Further, circulars on onsite examination in terms of a risk-based approach examination plan for 2017 and guidelines on Anti-Money Laundering and Countering the Financing of Terrorism (AML/CFT) compliance obligations for Money Value Transfer Service (MVTS) Providers, No. 1 of 2017 were issued on 17 January 2017 and 20 January 2017, respectively.

12.3 Domestic and International Cooperation

(a) Memorandum of Understanding

In 2017, the FIU signed two Memorandums of Understanding (MOUs) domestically with Department for Registration of Persons and Sri Lanka Police and five MOUs internationally with the Anti-Money Laundering Office (AMLO) of the Kingdom of Thailand, The FIU of the Kingdom of Bhutan, China AML Monitoring and Analysis, Qatar Financial Information Unit Center and FIU of Trinidad and Tobago to exchange/receive information for financial intelligence purposes. Accordingly, the total number of MOUs signed by FIU with foreign counterparts and domestic agencies increased to 37 and 05, respectively, as at end 2017.

(b) Egmont Group

FIU obtained assistance from members of the Egmont Group, the Association of the FIUs consisting of 155 member FIUs globally, in order to carry out investigations and collaborate with member countries to gather intelligence on their investigations. Total number of instances that the FIU exchanged information with Egmont members was 104 in the year 2017. The FIU – Sri Lanka received 50 requests from counterpart FIUs and the FIU - Sri Lanka also made 54 requests from counterpart FIUs to share information relating to on-going investigations. Further, the FIU officers participated in the Egmont Group of Financial Intelligence Units' Meetings held in Doha Qatar in February 2017 and the Egmont Policy and Procedures Working Group Inter-sessional Meeting held in Macao in July 2017.

(c) Asia Pacific Group on Money Laundering (APG)

The FIU hosted the 20th Annual Meeting of the APG in Colombo during 15-21 July 2017 with the participation of 408 delegates from 41 member countries of the APG and 24 observers from several international observer organisations. The event was graced by H.E. the President, Maithripala

Sirisenana and Hon. Mangala Samaraweera, Minister of Finance and Mass Media. The Annual Meeting was especially significant to Sri Lanka, as Sri Lanka became the APG Co-chair for the years 2016-2018, making it possible for the country to further show its commitment to implement actions to achieve international AML/CFT standards.

(d) BIMSTEC Sub-Group on Combating the Financing of Terrorism (BIMSTEC SG-CFT)

FIU officers participated in the meeting of the 9th SG-CFT of the Bay of Bengal Initiative for Multi Sectoral Technical and Economic Cooperation (BIMSTEC) held in Myanmar during 26-27 April, 2017.

12.4 Institutional Capacity Building and Awareness Programmes

In continued efforts to enhance the awareness on detecting, analysing and reporting of ML and TF related transactions, 31 awareness/training programmes were conducted during the year, accommodating 2,548 participants from LCBs, LSBs, LFCs and MVTs providers. The 1st and 2nd Technical Assistance Mission of the International Monetary Fund (IMF) was conducted by experts from IMF during the period 6-14 March 2017 and 25 September – 05 October 2017 respectively. The Mission provided technical assistance to strengthen three main areas under AML/CFT regime in Sri Lanka, Risk Based Supervision, FIU capacity developments and legislative amendments. The Resident Advisor from US Department of Treasury resumed his duties with the FIU in May 2017. He has been providing technical assistance to Sri Lanka under main three areas identified, FIU Operational Effectiveness, Financial Sector Supervision and AML/CFT Case Development and Asset Management.

12.5 Mutual Evaluation and Follow-up Work

In line with the revised recommendations of the Financial Action Task Force (FATF), the third round of Mutual Evaluation (ME) on Sri Lanka was conducted during 2014/15 by the APG with the intention of assessing Sri Lanka’s AML/CFT compliance with the international AML/CFT standards. The Mutual Evaluation Report (MER) adopted in September 2015 recommended a series of actions to be implemented by Sri Lanka under APG’s ‘expedite enhanced follow up’ process. In October 2016, the FATF informed that Sri Lanka will be subject to a review of the International Cooperation Review Group (ICRG) of the FATF to assess the progress of AML/CFT effectiveness. After several discussions and progress reports, the FATF informed that Sri Lanka has not made sufficient progress in 4 areas, namely International Cooperation, Supervision, Legal Persons and Arrangements and Targeted Financial Sanctions on Proliferations (North Korea & Iran). As a result, the FATF at its Plenary held at Buenos Aires, Argentina in October 2017, listed Sri Lanka as a jurisdiction with strategic AML/CFT deficiencies in the FATF’s Compliance Document which is more commonly identified as the “Grey List”. Upon listing, a time bound action plan to address the strategic

deficiencies identified was provided to Sri Lanka. The FIU and other relevant stakeholders have already taken necessary steps to implement the action plan recommended by FATF.

13. HUMAN RESOURCES

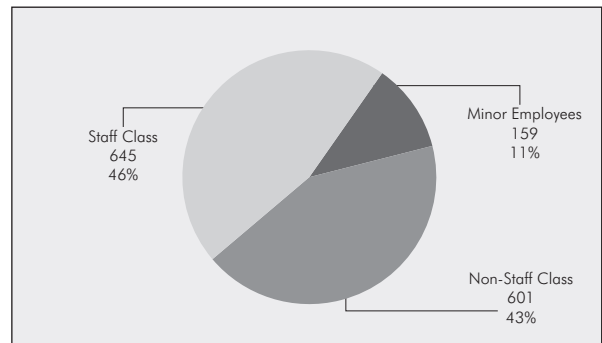
In 2017, Human Resources Department (HRD) continued its efforts to maintain well motivated, committed and talented pool of employees. HRD initiated actions to develop human resource management policies and adopt best practices with a view to improving employee engagement in achieving the core objectives of the Central Bank. In addition, HRD continued to carry out performance evaluation, employees rotation, succession planning, granting class and grade promotions and maintaining industrial harmony to create conducive environment to maintain better employer-employee relations. A summary of the activities carried out by HRD during the year 2017 and Human Resource structure of the Central Bank are given below.

13.1 Human Resources Structure

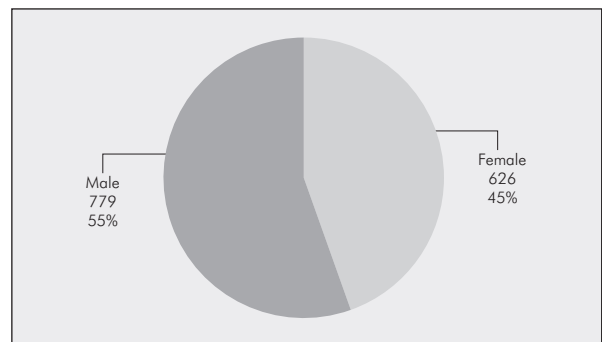
As at end 2017, the total number of staff of the Central Bank was 1,405 consisting of 645 Staff Class (SC) officers, 601 Non-Staff Class (NSC) officers and 159 Minor Employees (MEE). The average age of an employee of the Central Bank was 39 years at the end of the year 2017. The composition of SC, NSC and MEE categories in the total staff remained unchanged when compared to that of the previous year. The class-wise, gender-wise and age-wise composition of the staff as at end 2017 is shown in the chart II-4 below.

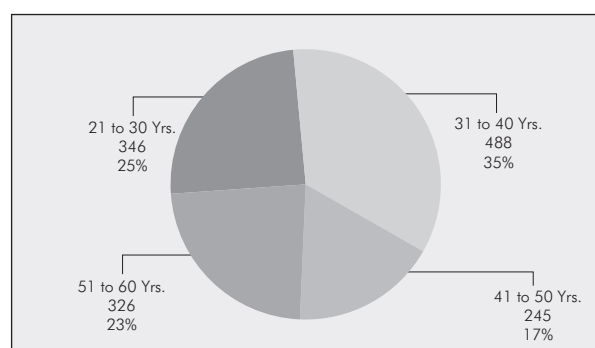
**Chart II - 4
Composition of the Staff as at 31.12.2017**

(a) Composition of Employees : Class-wise



(b) Composition of Employees : Gender-wise



(c) Composition of Employees : Age-wise**13.2 Educational and Professional Qualifications of the Employees**

As indicated in Table II -22, the Central Bank owns a diverse and talented pool of human resources with a high level of academic and professional qualifications.

13.3 Human Resources Management**(a) Recruitments**

In 2017, actions were taken to call applications for the posts of Management Trainee, Legal Officer, Security Officer (Male), Junior Personal Assistant and finalize the process of recruiting a suitable candidate for the post of Chief Librarian. In addition, arrangements were taken to recruit a Translator under the lateral recruitment process in order to fill the specific competency requirements of the Central Bank.

(b) Performance Management

Performance Management system of the Central Bank includes preparation and reviewing of job descriptions of employees, setting goals for individual employees, monitoring of employee performance and evaluation of performance.

Under the performance evaluation process, the level of performance of each employee is evaluated by assigning ratings for the performance achieved based on the generic and technical competencies as specified in the evaluation criteria. The final performance marks of employees are used as one of the requirements in the promotion criteria.

HRD carried out the employee performance evaluation process as planned during the year. Further, HRD

reviewed the mid- year performance review process of the departments. It provided an opportunity to understand the level of performance of the staff members during the first half of the year to the relevant parties.

(c) Promotions

In line with the applicable promotion criteria, HRD granted promotions for the employees ensuring their carrier progression and thereby, a total of 148 officers were granted their class and grade promotions in 2017. On this basis, 02 Assistant Governors were promoted as Deputy Governors, 06 Heads of Department were promoted to SC Special Grade as Assistant Governors and 02 Heads of the Department were promoted as Senior Heads of Department. Further, 34 SC Grade III (1) officers were promoted as Deputy Heads of Department and 92 officers were granted their grade promotions while promoting 12 officers to SC from NSC.

(d) Job Rotation

With a view of providing opportunities for employees to groom themselves in several areas of experiences of the operations of the Central Bank, HRD has taken actions to transfer 19 SC officers and 31 NSC officers with effect from 02 January 2017 under the Annual Job Rotation Policy of the Central Bank.

(e) Industrial Harmony

HRD continued to perform its role as the facilitator for maintaining a closer dialogue between the Management and Trade Unions. Accordingly, 09 discussions were arranged in 2017 giving the opportunity to the Management and Trade Unions to resolve some of the issues relating to remunerations, promotions, trainings, welfare of employees, recruitments and general administration of the Central Bank.

13.4 Closing down and Establishment of Department

In accordance with the new Foreign Exchange Act, HRD has made arrangements to close down the Exchange Control Department while establishing the Department of Foreign Exchange with effect from 20 November 2017.

13.5 Meetings attended by the Governor Abroad during the Year 2017

- (a) Participated in the Non-Deal Roadshow during the period, 13 - 18 March 2017 in San Francisco, Los Angeles, Boston and New York, USA.

Table II -22
Educational Qualifications/Professional Memberships of Employees of Central Bank as at 31.12.2017

Categories	PhD Holders	Master's Degree, First Degree & Professional Memberships	Master's Degree & First Degree	First Degree & Professional Memberships	First Degree only	Master's Degree & Professional Memberships	Professional Memberships only
Staff Class	20	87	174	50	159	17	15
Non-Staff Class	-	14	24	15	52	14	30
Minor Employee Class	-	-	-	-	7	-	-
Total	20	101	198	65	218	31	45

- (b) Participated in the Non-Deal Roadshow during the period, 27 & 28 March 2017 in London, UK and in Dubai, Middle East.
- (c) Travelled to Hong Kong to make a presentation at the 24th CLSA Investors' Forum held on 13 September 2017.
- (d) Attended the IMF/World Bank Annual Meetings 2017 in Washington during the period, 11- 14 October 2017 and attended the "Invest Sri Lanka" Investor Forum in New York on 16 October 2017 to deliver the keynote address.
- (e) Travelled to USA to make a joint presentation on "Sri Lanka's Post-Conflict Journey" with the Secretary General, Secretariat for Coordinating Reconciliation Mechanisms and the Secretary to the Ministry of Foreign Affairs, to the UN Peace building Commission on 20 November 2017 in New York.

13.6 Promotions/Appointments

- (a) Mr. K D Ranasinghe, Assistant Governor, was appointed as a Deputy Governor with effect from 30 April 2017.
- (b) Mr. C J P Siriwardana, Assistant Governor, was appointed as a Deputy Governor with effect from 19 August 2017.
- (c) Promotions and appointments to SC Special Grade were made as follows.
 - (i) Mrs. K M A N Daulagala, Mrs. S Gunaratne, Mr. N W G R D Nanayakkara, Mrs. T M J Y P Fernando, Mr. J P R Karunaratne and Mrs. K Gunatilake were appointed as Assistant Governors with effect from 31 August 2017.
 - (ii) Mr. U P Alawattage and Mr. M I Sufiyan were appointed as Senior Heads of Department with effect from 14 September 2017.
- (d) Dr. (Mrs.) Y M Indraratne, Additional Director of the Economic Research Department, was appointed as Acting Director of the Economic Research Department with effect from 10 January 2017.
- (e) Mr. U P Alawattage, Director of the Department of Supervision of Non-Bank Financial Institutions, was appointed as Controller of the Exchange Control Department with effect from 04 September 2017 and subsequently he was appointed as Director of the Department of Foreign Exchange with effect from 20 November 2017.
- (f) Mr. D M Rupasinghe, Director of the Regional Office Management Department, was appointed as the Director of the Centre for Banking Studies with effect from 11 May 2017 and subsequently, he was appointed as Director of the Macprudential Surveillance Department with effect from 04 September 2017. Thereafter, he was appointed as Superintendent of the Public Debt Department with effect from 28 September 2017 and subsequently, he was appointed as Director of the Financial Intelligence Unit with effect from 19 December 2017.
- (g) Mrs. C M D N K Seneviratne, Director of the Information Technology Department, was appointed as Superintendent of the Currency Department with effect from 04 September 2017.
- (h) Mr. A M N Gunawardana, Director of the Policy Review and Monitoring Department, was appointed as Director of the Internal Audit Department with effect from 04 September 2017.
- (i) Mr. B W Jinasena, Director of the Staff Services Management Department, was appointed as Secretary of the Central Bank with effect from 04 September 2017.
- (j) Mr. K H A S Ariyaratna, Secretary of the Central Bank, was appointed as Director of the Staff Services Management Department with effect from 04 September 2017 and subsequently, he was appointed as Director of the Macprudential Surveillance Department with effect from 28 September 2017.
- (k) Mrs. H P T Wijesuriya, Additional Superintendent of the Currency Department, was appointed as Acting Director of the Regional Office Management Department with effect from 11 May 2017 and subsequently, appointed as Acting Director of the Centre for Banking Studies with effect from 04 September 2017.
- (l) Mr. B L J S Balasooriya, Additional Controller of the Exchange Control Department, was appointed as Acting Director of the Regional Office Management Department with effect from 04 September 2017.
- (m) Mr. T D H Karunaratne, Additional Director of the Communications Department, was appointed as Acting Director of the Policy Review and Monitoring Department with effect from 04 September 2017.
- (n) Mr. K V K Alwis, Additional Director of the Information Technology Department, was appointed as Acting Director of the Information Technology Department with effect from 04 September 2017.
- (o) Mr. W Ranaweera, Acting Additional Director of the Department of Supervision of Non-Bank Financial Institutions, was appointed as Acting Director of the Department of Supervision of Non-Bank Financial Institutions with effect from 04 September 2017.
- (p) Mr. T H B Sarathchandra, Superintendent of the Public Debt Department, was appointed as Director of the Staff Services Management Department with effect from 28 September 2017.
- (q) Mrs. U L Muthugala, Additional Chief Accountant of the Finance Department, was appointed as Acting Chief Accountant of the Finance Department with effect from 20 November 2017.

- (s) Dr. M Z M Aazim, Additional Director of the Statistics Department, was appointed as Acting Superintendent of the Public Debt Department with effect from 19 December 2017.

13.7 Officers on Release

- (a) Mr. S R Attygalle, Assistant Governor, to the Ministry of Finance and Mass Media as Deputy Secretary to the Treasury
- (b) Mr. K M M Siriwardana, Assistant Governor, to the International Monetary Fund as Alternate Executive Director
- (c) Dr. P K G Harischandra, SC Grade IV officer, to the Ministry of Finance and Mass Media
- (d) Mr. U Hettiarachchi, SC Grade III (2) officer, to the HDFC Bank
- (e) Mrs. S Ratnayake, SC Grade II officer, to the International Monetary Fund as Administrative Assistant
- (f) Ms. S Amitha, SC Grade II officer, to the International Monetary Fund Resident Representative Office in Sri Lanka
- (g) Mr. S N W Karunadasa, Driver, to the Ministry of Power & Renewable Energy

13.8 Retirements

- (a) Mr. T M Z Mutaliph, Additional Director of the Macroeconomic Surveillance Department, retired from the Central Bank service with effect from 01 January 2017.
- (b) Mrs. R B Weerasinghe, Director of the Regional Office Management Department, retired from the Central Bank service with effect from 06 January 2017.
- (c) Mrs. J P Mampitiya, Assistant Governor, retired from the Central Bank service with effect from 19 January 2017.
- (d) Mrs. N H E R Siriwardena, Additional Director of the Department of Supervision of Non-Bank Financial Institutions, retired from the Central Bank service with effect from 28 January 2017.
- (e) Mr. S R Sumanasekara, Acting Additional Director of the Policy Review and Monitoring Department, retired from the Central Bank service with effect from 25 February 2017.
- (f) Mr. S Lankathilake, Deputy Governor, retired from the Central Bank service with effect from 30 April 2017.
- (g) Ms. K Saravanamuttu, Assistant Governor, retired from the Central Bank service with effect from 15 June 2017.
- (h) Mr. U H E Silva, Director of the Centre for Banking Studies, retired from the Central Bank service with effect from 11 August 2017.
- (i) Mr. S S Ratnayake, Assistant Governor, retired from the Central Bank service with effect from 14 August 2017.

- (j) Mr. P Samarasiri, Deputy Governor, retired from the Central Bank service with effect from 19 August 2017.
- (k) Mr. A A Chandrasena, Acting Additional Director of the Internal Audit Department, retired from the Central Bank service with effect from 23 August 2017.
- (l) Mr. A M R K Attanayake, Additional Director of the Regional Development Department, retired from the Central Bank service with effect from 26 December 2017.

14. INFORMATION TECHNOLOGY

Entrusted with the task of fulfilling the Information and Communication Technology (ICT) needs of the Central Bank, the Information Technology Department (ITD) continued its dynamic role of providing enterprise level integrated applications to achieve core objectives of the Central Bank.

During the year ITD made its contribution under five major areas, namely, (a) Delivering cost-effective business solutions; (b) Continuous enhancements of the IT infrastructure of the Bank; (c) Contribution to establish national payment system infrastructure; (d) IT security and resilience; (e) Upgrade ICT competencies among the staff.

(a) Delivering cost-effective business solutions

A new Auction System was implemented for the primary issuance of Treasury Bonds with three-phases to enhance the efficiency and transparency of domestic borrowings carried out by the Public Debt Department for the Government of Sri Lanka. The Currency Management System (CMS) used by the Currency Department was further enhanced by the addition of a new interface to capture banknote serial numbers from Single Note Inspection Machines (SNIM) to CMS electronically thereby streamlining the process of currency note consignment receipt from the supplier.

Monitoring market information and market participant information is an integral part of the Bank's activities. In this regard, the Central Integrated Market Monitor (CIMM) System was implemented to collect, analyze and report all information related to money market transactions from banks and dealers while capturing transactions directly in real-time from Bloomberg and Reuters systems for the Domestic Operations Department. The Central Database System (FinNet) used by several departments to monitor information reported by the Banks, Primary Dealers, Leasing Companies and Finance Companies was enhanced with the introduction of new analytical reports, extended surveillance and facility to record abandoned property.

The efficiency of the Country Wide Data Collection System of the Statistics Department was enhanced by introducing a new tablet computer based system to collect prices of goods from teachers stationed in all parts of the island.

The EPF system which manages the information pertaining to all the EPF members in Sri Lanka was further enhanced

by incorporating new processing and informational requirements to improve the efficiency of its main IT system.

(b) Continuous enhancements of the ICT infrastructure

ITD ensured continuous and efficient delivery of IT services in the Bank by taking a number of initiatives.

One of the major infrastructure development projects completed during the year was segregating the corporate network into different segments. Consequently, business critical IT systems were separated from the general IT environment and tight logical and physical security controls were enforced on them. Further, internet access was restricted and privileges were separated on these systems and user computers that have access to these systems reducing vulnerabilities and exposure to cyber-attacks.

Introduced an advanced threat analytics platform to protect the bank from multiple types of advanced targeted cyber-attacks and insider threats. It gathers information from multiple data-sources in the corporate network to learn the behavior of users and other entities in the organization and detects multiple suspicious activities and generates alerts about them.

ITD is continuously striving to create a paperless work environment in the bank and several initiatives were taken in this regard during the previous year. An automation software was implemented to digitize the current paper based board papers and to manage the full process of board meetings digitally. It enabled the board members and other participants of such meetings to access and manage board meeting related content electronically. Further, initial requirement gathering was completed to introduce a document management system to the Bank. This system would further facilitate the movement towards a paperless environment.

(c) Contribution to establish national payment system infrastructure

ITD continued to function as an advisor and a provider of technical expertise for projects of national interest as per the road map of the National Payment Council. ITD Officials contributed their expertise to several national projects during the year.

The establishment of an electronic trading platform and a Bond Clearing house with a Central Counter Party is an important national project set in motion to strengthen the financial market infrastructure. ITD officers served in the Technical Evaluation Committee (TEC) appointed for the selection of a suitable vendor for the project implementation.

SWIFT is the secure financial messaging platform used in the national payment system. According to the Customer

Security Program (CSP) announced by SWIFT, security controls were introduced by segregating the SWIFT network from the main LAN and dedicating terminals only for SWIFT operations.

In addition, ITD officials assisted the Payments and Settlements Department (PSD) to formulate policies and guidelines for the minimum compliance standard for mobile applications and also to carry out onsite examinations on Dialog Data Centre, Dialog eZ cash, and Dialog Transport Card System.

(d) Strengthening IT security and resilience

ITD took several measures to enhance IT Security and protect the Bank's IT assets from any cyber security threats. As a proactive approach, continuous vulnerability assessments were carried out on business-critical IT systems to identify vulnerabilities and necessary remediation actions were taken where necessary to mitigate them and reduce exposure to cyber-attacks. User awareness programs were also carried out to acknowledge employees of critical vulnerabilities and the recommended course of action to stay safe.

Technical Infrastructure setup was completed to introduce digital information classification and a new information classification policy was drafted to be included in the Information Security Policy of the Bank

(e) Upgrading ICT competencies among the staff

With an aim to enhance the IT knowledge of all employees in the Bank, ITD continued to publish awareness banners on the intranet and circulate security advisory alerts through email. Further, in order to uplift the knowledge and skills in the relevant fields, the staff of ITD attended short term training both locally and abroad.

15. INTERNAL AUDIT

The Internal audit function has been in operation in the Central Bank of Sri Lanka since 1951. The mission, scope of work, accountability, independence, responsibility and the authority of the Director and the staff of the Internal Audit Department (IAD) have been included in the Internal Audit Charter approved by the Monetary Board. Audits are performed in line with global standards and industry best practices. A summary of the activities carried out by the Department during 2017 is given below.

15.1 Internal Audit Plans

Strategic Internal Audit Plan (SAP) was developed for three-year period covering 2018-2020. Based on the SAP, Annual Audit Plan (AAP) for 2018 was developed. Both SAP and AAP were reviewed by the Monetary Board Advisory Audit Committee (AAC) and approvals were obtained from the Monetary Board.

15.2 Conduct of Audit Assignments

(a) Process and Information System Audits

In 2017, process and information system audits were conducted covering many areas of the Central Bank. Each audit engagement was carried out in four sequential steps in general, i.e., planning, performing, communicating and taking resolution actions. In line with global standards, a four step process was followed for the communication of audit results; conduct of closing conference to get audit observations validated, communication of audit observations in writing, issuing of draft audit report and issuing of final report. Follow-up audits were also conducted at regular intervals to obtain assurance that the communicated audit recommendations were implemented by process owners.

(b) Conduct of Spot Audits

Spot audits were also conducted in 2017 as required and communicated audit results to the process owners and other stakeholders.

(c) Special Assignments

Special reviews were conducted on Reserve Money Data reported to the IMF on test dates by the Economic Research Department as recommended by the IMF Safeguards Mission.

(d) Reporting the Progress of the Conduct of Audits

The progress of conducting audit assignments was reported to the AAC and the Monetary Board, quarterly. Activity reports were submitted to the Auditor General on half-yearly basis.

15.3 Awareness Programmes and Provisioning of Training

IAD conducted an Awareness Programme on Internal Audit for the officers of the Royal Monetary Authority of Bhutan. Further, IAD conducted a presentation for the Audit Coordinating Officers on the 'Internal Audit Facilitation Guidelines'. As requested by the Human Resources Department, IAD continued to provide training on internal audit and related disciplines to undergraduates and the students of the Institute of Chartered Accountants of Sri Lanka during the year.

15.4 Facilitation to the Monetary Board Advisory Audit Committee

AAC is a sub-committee of the Monetary Board which advises the Monetary Board on financial reporting, internal controls and risk management systems, compliance, whistleblowing and fraud, internal audit, external audit and any other matter assigned by the Monetary Board. Secretary to the Monetary Board is the Secretary to the AAC. Director of the Internal Audit Department (IAD) functions as the Assistant Secretary to the AAC. Accordingly, IAD provided secretarial facilitation to the AAC during the year.

16. INTERNATIONAL OPERATIONS

In terms of the Monetary Law Act (MLA), the Central Bank is responsible for managing the official foreign reserves of the country. In this regard, International Operational Department (IOD) has been entrusted to perform the reserve management function and to monitor the domestic foreign exchange market to ensure its smooth operation.

The MLA provides the necessary legal framework for foreign reserves management, covering areas on the maintenance and composition of foreign reserves, actions to preserve the international stability of the Rupee, scope of foreign exchange operations of the Central Bank and the powers and responsibilities of the Monetary Board pertaining to foreign reserves management activities. In this aspect, Section 67 of MLA deals with the parameters in respect of asset types, counterparties, instruments and issuers. The Monetary Board may also direct to further widen the scope of reserves management activities to enhance the safety, liquidity and return objectives of reserves management.

16.1 Foreign Reserves Management

Investments of foreign reserves are undertaken in accordance with the Foreign Reserves Management Guidelines as amended and approved by the Monetary Board, under the supervision of the Foreign Reserves Management Committee (FRMC) taking into consideration the safety, liquidity and return objectives. The foreign reserves are denominated in several key currencies and are mainly invested in Fixed Income Securities (FIS), Money Market Investments and Gold. The FIS portfolio consists of highly rated government securities, government guaranteed securities, securities of government agencies and supranational institutions. Transactions undertaken by IOD for reserve management purposes, are performed with Central Banks, highly rated commercial banks and investment houses, which are counterparties approved by FRMC as per the parameters stipulated in the Counterparty Credit Risk Management System (CCRMS) subject to the necessary limit allocations by the Risk Management Department, paying due consideration to the strength and creditworthiness of each counterparty. The key factors considered in determining the asset and currency compositions of the foreign reserves portfolio constitute liquidity requirements and debt service payments while risk management parameters, income generating abilities and specific directions of the Monetary Board are also considered.

The global economy marked a gradual improvement which reflected through the steps taken by the global central banks enduring policy normalization. The Federal Reserve Bank of USA, based on the strength of the economy and improving labor market, began to roll back its stimulus program and raised interest rates three times during the year 2017. In Europe, the economy showed positive developments during the year where unemployment was gradually falling and

emerging signs of inflation pressure being evident, prompting a reduction in stimulus measures including an interest rate hike in coming year 2018. The Japanese economy also gradually pushed toward its target inflation goal.

North Korean nuclear weapon threats continued from time to time during the year where it raised international tensions in the region and beyond. This activist approach in the Middle East and North Korea led to higher global tensions and increased appetite for “safe havens”, with lower US and German bond yields and a stronger yen during the second half of 2017. Global oil prices started to pick up by the third quarter of the year due to OPEC member countries agreed on supply restrictions. In this dynamic global setting, IOD secured a total return of US Dollars 153 million during the year 2017 through money market investments and capital gains and coupon income derived from FIS and the marked to market return on gold, foreign currencies and FIS.

In 2017, the Central Bank completed its first full year with the Reserve Advisory and Management Programme (RAMP) of the World Bank. RAMP is conducted by World Bank Treasury which provides advisory services and training to official sector investment managers enabling efficient management of foreign currency reserves and other investment portfolios. During 2017, the Central Bank aligned to its Strategic Asset Allocation (SAA) which was constructed by determining the appropriate asset allocation scientifically at any point of time to achieve its medium and long term investment objectives of future payment obligations, preservation and enhancement of capital and so on. Under the RAMP, the World Bank Treasury was appointed as an external manager for the Central Bank reserve management by allocating US Dollars 200 million out of the foreign reserves to invest in high-grade government, government guaranteed and supranational bonds for a period of three years.

During 2017, three missions for technical assistance on foreign reserves management were conducted as in-house trainings in the Central Bank with the assistance of World Bank technical experts. These missions focused on capacity building on portfolio management, risk and performance measurement and reporting structures under the SAA structure. In addition World Bank hosted a 5-day international workshop in February 2017 at the Central Bank for participants of RAMP member countries, where the Central Bank co-hosted the event.

16.2 Performance Analysis and Facilitation Activities

Under Performance Analysis and Facilitation, the following main functions relating to the Central Bank’s reserves management are conducted.

(a) Performance Measurement

IOD daily assesses performance of its reserve management activities on total return approach and presents to the FRMC monthly, and quarterly to the Monetary Board, together with

an analysis of reserve position and its trend. The returns of FIS investments are measured against selected benchmarks according to the SAA approved by the Monetary Board. Comparison against benchmarks helps to determine the effectiveness of the Central Bank reserves management strategy by computing extra risk, if any, taken by the Central Bank is adequately compensated by subsequent extra returns. Initiatives have been taken to further elaborate total returns generated through foreign reserves management using performance attribution by IOD in 2018. Accordingly, the resulting findings could be used as value adding inputs in the Central Bank’s foreign reserve management strategy to produce higher long-term returns.

(b) Administration of Treasury Management System (TMS)

IOD, the main user of the TMS, is responsible for the general administration function of the system and ensures a proper coordination among other user Departments, the software provider and its local partner. Accordingly, IOD ensures that the TMS is updated with relevant modifications/ patches and is fully connected with internal systems such as Society for Worldwide Interbank Financial Telecommunications (SWIFT), Real Time Gross Settlement (RTGS) and General Ledger (GL) as well as external interfaces such as Bloomberg and Reuters to ensure efficient functioning of TMS related procedures and processes.

Measures were taken during 2017 to perform essential modifications to the current TMS in order to facilitate tranche-wise classification of foreign reserves as per the new SAA, to automate the end-of-day rollover process and to further enhance the controls of the current TMS.

(c) Monitoring of Non-Financial Risks

IOD identifies the non-financial risk profile relating to the reserves management activities and proposes relevant risk mitigation actions to the Non-Financial Risk Management Committee (NFRMC) on quarterly basis.

(d) Annual review of existing counterparties for their adherence/compliance to Anti Money Laundering (AML) and Combating Financing of Terrorism (CFT)

During 2017, IOD carried out its first “Know Your Customer (KYC)/ Customer Due Diligence (CDD) rules for the Central Bank of Sri Lanka for the foreign counterparties” to ensure the compliance with rules and regulations and international best practices in relation to AML and CFT with regard to management of foreign reserves.

16.3 Domestic Foreign Exchange Market Developments

IOD continued to monitor the transactions in the domestic foreign exchange market to ensure its smooth operation and initiated appropriate actions to curb the excess volatility in the USD/LKR exchange rate. Unwinding of the foreign investments in government securities market with the expectation of an interest rate hike by the Federal Reserve

Bank of USA in March, post Brexit developments in Europe and escalated tension related to North Korea exerted pressure on the Sri Lankan rupee to depreciate in early 2017. The pressure on the exchange rate escalated further due to the debt service payments and increased import demand during the first quarter of 2017. However, with the conversions by exporters and the positive sentiments created through the receipt of the third and fourth tranches under the Extended Fund Facility of the International Monetary Fund (IMF), the pressure on the exchange rate eased gradually towards the end of 2017. This was further supported by policy initiative on allowing the market forces to determine the exchange rate with the accommodation of greater flexibility in the exchange rate during the year 2017.

In 2017, total interbank foreign exchange transaction volume has increased to US Dollars 16.45 billion from US Dollars 14.8 billion in 2016 (Table II-23). The aggregate limit on the Net Foreign Exchange Open Position of the Licensed Banks (LBs) remained unchanged at US Dollars 197 million during the year. Further, Central Bank intervention indicated a net purchase position of US Dollars 1,664.35 million during the year as compared to the net sales of US Dollars 768.16 million in 2016 (Table II-24).

In 2017, an integrated market monitoring system named "Central Integrated Market Monitor (CIMM)" was developed to improve the existing domestic interbank foreign exchange reporting system, in collaboration with the Information Technology and Domestic Operations Departments with a view to strengthen the real time reporting and monitoring of interbank transactions. This new reporting system is linked with the Bloomberg and Thomson Reuters trading platforms and market participating institutions to automatically capture the interbank FX transactions, and is operational with effect from 2 January 2018.

Table II - 23
Inter-Bank Foreign Exchange Transactions
Volume - 2017

USD mn					
Month	Spot	Tom	Cash	Forward	Total
January	305.42	187.13	205.11	845.68	1,543.34
February	233.20	185.05	262.65	894.55	1,575.45
March	186.25	193.80	276.40	1,052.34	1,708.79
April	164.50	178.75	215.50	762.01	1,320.76
May	116.50	89.95	172.06	676.33	1,054.85
June	241.35	297.50	209.85	782.31	1,531.01
July	314.31	277.15	339.71	542.24	1,473.42
August	296.43	207.74	300.66	541.07	1,345.91
September	265.35	225.00	245.45	460.03	1,195.83
October	294.72	179.35	277.10	434.05	1,185.22
November	304.67	159.15	247.43	539.63	1,250.87
December	291.01	224.83	255.04	494.79	1,265.67
Total	3,013.69	2,405.40	3,006.97	8,025.06	16,451.12

Source : International Operations Department, Central Bank of Sri Lanka

Table II - 24
Purchases and Sales of Foreign Exchange by the
Central Bank - 2017

USD mn			
Month	Purchases	Sales	Net Purchases/ (Sales)
January	64.66	204.50	(139.84)
February	145.09	297.25	(152.16)
March	192.23	13.00	179.23
April	257.91	-	257.91
May	183.48	35.00	148.48
June	136.00	-	136.00
July	344.75	-	344.75
August	200.00	-	200.00
September	186.50	-	186.50
October	97.00	-	97.00
November	206.00	-	206.00
December	200.50	-	200.50
Total	2,214.10	549.75	1,664.35

Source : International Operations Department, Central Bank of Sri Lanka

17. LEGAL AND COMPLIANCE

Legal and Compliance Department (LCD) is entrusted with the duty to ensure integrity of the Central Bank in all legal and procedural aspects in achieving its core statutory objectives, to develop new laws and review existing laws relating to the functions of the Central Bank and to formulate an effective compliance framework, with a view to ensure compliance policies and procedures are followed and that management takes appropriate corrective action when compliance failures are identified. In this capacity, LCD undertakes wide range of activities with a view to safeguard the legal interests of the Central Bank and to ensure contemporariness of the legal and regulatory framework. LCD is also required to contribute to accomplish strategic priorities of the Central Bank. The major activities carried out by LCD during 2017 are summarized below.

(a) Ensuring integrity of the Central Bank in all legal and procedural aspects

During the year under review, the LCD advised the Monetary Board and the departments of the Central Bank on legal aspects in policy formulation as well as the operational activities of the Central Bank.

LCD provided advice and technical support to initiate action on financial institutions that have been in violation of the provisions of the relevant laws to strictly enforce compliance with the laws, and where necessary to initiate efficient resolution of such companies.

While a majority of such advice was aimed at achieving financial system stability, LCD also advised on legal issues pertaining to other responsibilities of the Central Bank, such as its agency functions and corporate services. In this regard, review of legal agreements and contracts to be entered into by the Central Bank and notarial execution of deeds and

other legal instruments relating to the Central Bank has been undertaken by LCD.

(b) Litigation

LCD was responsible for handling litigation where the Monetary Board, the Central Bank or its employees were parties, in consultation with the law enforcement authorities. In the year 2017, none of the cases handled by the Department resulted in an adverse finding against the Bank.

(c) Law Reforms

LCD facilitated the introduction of the Foreign Exchange Act, and conducted reviews of major legislations such as the Monetary Law Act, Banking Act, Payment and Settlement Systems Act, Registered Stock and Securities Ordinance and the Local Treasury Bills Ordinance. Such activities were aimed at addressing emerging issues and identified deficiencies in the financial sector infrastructure.

(d) Compliance

Towards achieving its compliance related objectives, the LCD has continued developing a comprehensive compliance manual for the Central Bank. In addition, LCD finalized a whistleblowing policy and has commenced drafting a code of conduct for the employees of the Central Bank, to ensure integrity of the operations of the Central Bank by enhancing work and professional ethics of the staff. The functions relating to Right to Information Act, No. 12 of 2016 have been attended by LCD in consultation with the relevant departments of the Central Bank.

(e) Public Awareness

In order to promote awareness of different stakeholders on developments in laws relating to central banking, and on areas such as unauthorised finance business, prohibited schemes and financial inclusion, the staff of LCD has participated as resource persons in a wide array of fora throughout the country.

(f) Enforcement Unit

As per the decision taken by the Monetary Board at its meeting No.21/2017 held on 16 June 2017, the Enforcement Unit had been established with effect from 01 July 2017 as a division within LCD. Main objectives of the Unit were to carry out the functions relating to enforcement and resolution of banks and finance companies, taking legal actions against distressed finance companies, combating prohibited schemes and illegal deposit taking etc. A special police unit consists of four police officers from Financial Crimes Investigation Division was also established to assist the activities of the Enforcement Unit.

The Enforcement Unit had been empowered to conduct investigations in to prohibited schemes stipulated by the provisions of section 83C of the Banking Act, No. 30 of 1988 and take actions against unauthorised deposit taking under the provisions of the Finance Business Act, No. 42

of 2011. Accordingly, investigations were initiated into the activities of one company involved in unauthorised deposit taking and four companies that conducted suspicious prohibited schemes.

The Enforcement Unit was transformed into a Department of the Central Bank with effect from 01 January 2018 and it was named as the Resolution and Enforcement Department.

18. MACROPRUDENTIAL SURVEILLANCE

Macroprudential Surveillance Department (MSD) has been equipped with resources and data to assess systemic risks and vulnerabilities in the financial system with utmost objectivity since its inception in 2007. Complementing Central Bank's objective of maintaining financial system stability, the Department has been entrusted with formulating proactive macroprudential policy tools to mitigate risks affecting financial system stability. Various statistical analyses, stress tests on financial institutions, studies relating to interconnectedness amongst key stakeholders in the system and surveys conducted by MSD on the market perception on stability and risks largely contributed towards achieving the said objective. The following are key activities of the Department during the year.

(a) Macroprudential Surveillance

Given its purpose, MSD continued to compile several financial soundness indicators with the objective of assessing the financial soundness of financial institutions such as banks, licensed finance companies and publicly listed companies as well as financial markets and the macroeconomy. In addition, early warning indicator to forecast pressure on the local currency was compiled. Findings of these analyses were regularly submitted to the Monetary Board in the quarterly Board Papers on financial system stability.

In view of the need for granular data for macroprudential analyses, an inter-department technical committee was initiated by MSD to streamline efficient data collection from external parties and conflict free sharing of such data within the Central Bank.

(b) Surveys

A clearly articulated bi-annual Systemic Risk Survey was initiated at the beginning of the year and received immense support from financial sector professionals in identifying the market perception on the potential risks to the financial system and financial system stability. Furthermore, a plan for a household sector survey was laid out due to increasing financial and social concerns on rising indebtedness of households in Sri Lanka. Accordingly, MSD collaborated with the Statistics Department of the Central Bank to conduct the survey on household indebtedness and gather information.

(c) Reports and publications of the Central Bank

Contribution of MSD to statutory reports of the Central Bank of Sri Lanka was made by coordinating and

compiling chapter 8 of the 2016 Annual Report and the report submitted to the Minister of Finance. In addition to that, chapter 8 of Recent Economic Developments, i.e. Financial Sector Developments and Stability was compiled by the Department with the collective effort of other departments of the bank, that are involved in the financial sector and external stakeholders such as Department of Co-operative Development, Department of Labour, Department of Pensions, Employees' Trust Fund Board, Insurance Regulatory Commission of Sri Lanka, SANASA Federation, Securities and Exchange Commission of Sri Lanka, Unit Trust Association of Sri Lanka and venture capital companies. MSD is also in the process of publishing Financial System Stability Review 2017. The purpose of these reports is to provide comprehensive facts and figures on financial institutions, markets and infrastructure for stakeholders to gauge an idea on the financial system and its stability. The Department continuously endeavours to apprise the public of performance, associated risks, opportunities and regulatory developments of the nation's financial system.

19. PAYMENTS AND SETTLEMENTS

Payments and Settlements Department (PSD) was established in 2002 to discharge the responsibilities entrusted to the Central Bank under Section 62A of the Monetary Law Act which provides authority for the Central Bank to establish and operate systems for transfer of funds, settle payment obligations and issue system rules to participating institutions. In addition, with the enactment of the Payment and Settlement Systems Act, No. 28 of 2005, PSD was entrusted to discharge the Central Bank's responsibilities under this Act as well.

Main functions carried out by PSD are; operation of the Real Time Gross Settlement (RTGS) System, providing back-office service for financial transactions, management of the SWIFT Communication System, facilitating transactions under the Asian Clearing Union (ACU), facilitating the development of the national payment switch and regulation and oversight of Payment and Settlement Systems (PSS). A summary of the main functions performed by the PSD during 2017 is given below:

19.1 Operation of the Real Time Gross Settlement System

- (a) PSD operated the RTGS System, which settles time critical and large value inter-participant payments as well as customer payments on real time gross basis, and facilitated and monitored the provisioning of the Intraday Liquidity Facility (ILF) to the Participating Institutions (PIs) which requested extra funds to ensure smooth functioning of the RTGS System. PIs of the RTGS System are the Central Bank, Licensed Commercial Banks (LCBs), Non-Bank Primary Dealer Companies (PDs), Employees' Provident Fund and the Central Depository System of the Colombo Stock Exchange.

- (b) As at end of 2017, the number of PIs of the RTGS System was 36. During the year, the RTGS System settled 377,312 transactions with a total value of Rs. 92,303 billion. The average volume and average value of RTGS transactions settled per day were 1,566 and Rs. 383 billion, respectively. With regard to ILF operations, on average, Rs. 47.4 billion per day was released to PIs. Adhering to international best practices, the RTGS System availability was maintained at a high level of 99.71 per cent during the year.

19.2 Providing Back-Office service for financial transactions of the Central Bank

(a) Back-Office service for Foreign Exchange Transactions

During 2017, back-office services provided to facilitate international reserve management of the Central Bank covered the following:

- i. Settled 10,475 transactions relating to foreign exchange trading and funding, money market, fixed income securities, gold trading, Asian Clearing Union and Repo/Reverse Repo amounting to US Dollars 357.2 billion during 2017.
- ii. PSD was involved in the modification project of the Treasury Management System (TMS) by providing inputs with regard to back-office requirements.

(b) Back-Office service for Open Market Operations

The back-office functions of open market operations with LCBs and PDs were carried out to facilitate the management of liquidity requirements of the open market participants. Accordingly, during 2017, PSD effected and facilitated 1,212 repo transactions amounting to Rs. 3,327 billion, 3,130 Standing Deposit Facility transactions amounting to Rs. 3,955 billion and 2,844 Standing Lending Facility transactions amounting to Rs. 2,130 billion, 1,860 reverse repo transactions amounting to Rs. 1,050 billion, and 89 outright sales transactions amounting to Rs. 109 billion.

19.3 Management of the SWIFT Communication System

PSD uses SWIFT service in its communication on financial operations, and manages the SWIFT system on behalf of all users of the Central Bank. Therefore, PSD maintains the system according to the standards set by the SWIFT Head Quarters on software, hardware, processes, procedures and risk management controls. To maintain a better connectivity and provide a better service, the Central Bank obtains the connectivity to SWIFT-Net via the indirect connectivity through Lanka Financial Services Bureau Ltd.

Internationally, 2017 was also a challenging year for SWIFT user community due to the increase of operational and system risk. SWIFT System was upgraded several times by

the service provider to a new version (version 7.1.40) to provide a more efficient and secure service with improved facilities for their customers. Accordingly, the Central Bank has successfully installed the new version and lined up with the international standards for the facilities introduced by the SWIFT service. The Central Bank also introduced several security measures in order to maintain the security level of SWIFT division throughout the year.

In 2017, the total number of SWIFT messages sent and received were 1,438,115 and 801,620, respectively. Out of the total messages received 230,819 were for the Central Bank transactions while the balance was for RTGS and securities related transactions.

19.4 Facilitating Transactions under the Asian Clearing Union

PSD continued to facilitate settlement of eligible transactions among 9 member central banks of the ACU on a multilateral net basis during the year 2017. The total number of transactions effected through the ACU mechanism during the year was 6,335 and the value of total transactions was Rs. 533.6 billion. The value of net settlement made under the ACU mechanism was Rs. 459.7 billion.

The 46th meeting of the ACU Board of Directors and the Standing Technical Committee meeting were held in Colombo in July 2017 and the Governor of the Central Bank was appointed as the Chairman of Board of Directors of the ACU for a period of one year. Secretary General of ACU and delegates of member central banks and monetary authorities participated at this meeting.

19.5 Facilitating the Development of the National Payment Switch

PSD continued to facilitate the establishment of the Common Card and Payment Switch (CCAPS) operated by LCPL under the brand name of 'LankaPay'. CCAPS, which is designated as the National Payment Switch of the country, consists of five switches i.e. Common ATM Switch (CAS), Common Electronic Fund Transfer Switch (CEFTS), Shared ATM Switch (SAS), Common POS Switch (CPS) and Common Mobile Switch (CMobS). In order to assist implementation of CCAPS, PSD monitored the progress of implementation of CCAPS according to the timelines imposed for joining CCAPS by the Payment and Settlement Systems Circular No. 07 of 2015 and progress of implementation of CCAPS is as follows;

(a) CAS, which is the first phase of CCAPS, started live operations in July 2013. At the end of 2017, membership of CAS increased to 27. During the year 2017, CAS settled 33 million transactions amounting to Rs. 264.1 billion. In order to enhance the security of card transactions carried out through CAS network, CAS members were instructed to enable EMV technology in ATM machines installed by them.

(b) CEFTS, which is the second phase of CCAPS, was implemented on 21 August 2015. CEFTS provides a common infrastructure to clear payments effected through multiple payment channels such as ATM, Internet Banking, Mobile Banking, Kiosks and over-the-counter. During 2017, 11 financial institutions integrated with CEFTS increasing the members of CEFTS to 33. During the year 2017, CEFTS settled 3.2 million transactions amounting to Rs. 273.7 billion.

(c) LankaPay Online Payment Platform (LPOPP) was launched on 20 July 2017 to facilitate real time payments to Sri Lanka Customs. At present, 07 licensed commercial banks have connected to LPOPP. In order to increase the maximum per transaction value limit for transactions carried out through a specific transaction code to facilitate real time payments to Sri Lanka Customs, Payment and Settlement Systems Circular No. 08 of 2017 on Maximum Limits on Transaction Value and Fees of Common Electronic Fund Transfer Switch was issued replacing the Payment and Settlement Systems Circular No. 01 of 2015. Considering a request made by the Commissioner General of Inland Revenue to integrate Revenue Administration Management Information System (RAMIS) of the Inland Revenue Department (IRD) with LPOPP, granted approval for LCPL to integrate LPOPP with RAMIS.

(d) Approval was granted to LCPL to implement a National Card Scheme in partnership with an international card scheme. Accordingly, the National Card Scheme, which will facilitate introduction of low cost payment card products, will be implemented in 2018. CPS will commence live operations after implementation of the National Card Scheme.

19.6 Regulation and Oversight of Payment and Settlement Systems

PSD continued its regulatory and oversight activities to ensure security and efficiency of the electronic payment systems. Accordingly, the following major activities were carried out by PSD during 2017.

(a) In terms of the provisions of the Payment Cards and Mobile Payment Systems Regulations No. 1 of 2013, granted approval to a Finance Company which was authorized to issue debit cards as a licensed Service Provider of Payment Cards to issue credit cards. In addition, approval was granted to a LCB, licensed as a Service Provider of Payment Cards to function as a Service Provider of Mobile Payment Systems.

(b) Considering the risks associated with mobile phone based e-money systems, PSD conducted on-site supervision on licensed operators of mobile phone based e-money systems to ensure implementation of the recommendations made to the respective service

providers in order to ensure the reliability and smooth functioning of the said systems.

- (c) Continued off-site surveillance to examine compliance of service providers to the Mobile Payment Guidelines and Credit Card Guidelines and other regulations in order to ensure safety and efficiency of retail payment systems operating in the country.
- (d) Evaluated the Business Continuity Plans of the LankaSettle participants and LankaClear (Pvt.) Ltd. in order to ensure their readiness to continue business operations in an emergency.

19.7 National Payment Council (NPC)

The PSD served as the executing arm of the NPC which was set up in 2006 in terms of provisions of the Payment and Settlement Systems Act, No. 28 of 2005. The NPC is the industry consultative and monitoring committee on payment systems. The NPC consists of members from the relevant departments of the Central Bank, licensed banks, financial sector institutions and associations and mobile payment service providers. Considering the importance of introducing emerging innovative payment technologies, NPC initiated actions to study developments in the financial technology (FinTech) sector and Blockchain technology.

19.8 Public Awareness

PSD continued to publish the quarterly "Payments Bulletin" on the CBSL website for dissemination of information and statistics on payment and settlement systems operating in the country. Further, PSD conducted 05 awareness programs on a need basis to educate the general public and the banking community on payment systems and other related issues. In order to promote electronic payments, published advertisements in daily newspapers to educate customers on CAS, CEFTS and Sri Lanka Interbank Payment System.

20. POLICY REVIEW AND MONITORING

Policy Review and Monitoring Department (PRMD) being the facilitator in the Strategic Planning process of the Central Bank reviews the implementation of the Strategic Plan of the Bank, improving the effectiveness of policies and ensuring that the strategic plan is successfully implemented in order to achieve the desired outcomes within the stipulated timelines.

20.1 Preparation of Strategic Plan 2017 - 2021, Reviewing Progress and Reporting to the Management

The Strategic Plan of the Central Bank for 2017 - 2021 under the theme of 'Breaking the Vicious Cycle' was launched at the New Year Work Commencement Ceremony 2017 held on 02 January 2017. During the following week, awareness meetings on the Strategic Plan 2017 - 2021 were conducted on the cluster basis and copies of the Strategic Plan publication were distributed among all the employees. Progress review meetings were conducted quarterly to assess the implementation of strategic/action plans and progress

was reported to the Monetary Board highlighting the issues encountered in implementing strategic/action plans and the reasons for activities that were not fully implemented as expected in departmental strategic/action plan.

20.2 Strategic Priorities 2018 - 2020

In order to incorporate appropriate improvements to the existing Strategic Planning process, the PRMD organized the seminar on Strategic Planning 2017 on 03 - 04 October 2017 with the assistance of the Bank of England. Thereafter, Strategic Planning Retreat 2017 was conducted on 28 - 29 October 2017 and the insights from this seminar was extensively discussed at the Retreat while highlighting the importance of identification of bank-wide strategic priorities for a three-year period. Establishing a remarkable milestone in the Strategic Planning process of the Central Bank, six (06) strategic priorities were identified by the senior management as the bank-wide strategic priorities for 2018 - 2020. Concept papers on strategic priorities including the strategic objectives with time-bound strategic actions for the next three years, which were articulated by the Task Forces set up for the said purpose, were approved by the Monetary Board with the recommendations of the Corporate Management Committee (CMC).

20.3 Departmental Action Plans

New improvements were introduced to the annual departmental action plans and thus, the departmental action plan consists of (i) strategic activities relevant to the department which are emanating from the bank-wide strategic priorities in the corresponding year and (ii) operational activities of the year. In order to capture the expected outcome and impact, appropriate Key Performance Indicators (KPIs) were identified by each department under strategic/operational actions. Progress of implementation of the strategic priorities and departmental action plans will be reviewed at one-to-one meetings on a quarterly basis and reported to the CMC and the Monetary Board, respectively.

20.4 Forwarding Reports to Ministries and Other Government Institutions

Regular updates on the implementation of the Budget proposals 2017, performance reports on the Central Bank activities and required information for Audit and Management Committee meetings were forwarded to Ministry of National Policies & Economic Affairs as requested. In addition, any other information requested by other government institutions was timely provided as appropriate.

21. PUBLIC DEBT

The Public Debt Department (PDD) is responsible for discharging statutory responsibilities of the Central Bank of Sri Lanka as agent of the government for management of public debt in terms of section 113 of the Monetary Law Act. In order to meet these responsibilities, PDD was established on 28 August 1950, at the inception of the Central Bank.

The major functions of PDD include raising funds to meet the gross borrowing requirement of the Government as per the Appropriation Act, meeting the government debt service payments on time, maintaining the LankaSecure system in order to facilitate the smooth functioning of settlement of market transactions in government securities and maintaining the title Registry of government securities in the Central Depository System (CDS). In addition, PDD also engages in developing the government securities market in the country.

21.1 Raising of funds to meet the Government gross borrowing requirement as specified in the Appropriation Act.

- (a) The issuance of Treasury bills (T-bills), Treasury bonds (T-bonds), Sri Lanka Development Bonds (SLDBs) and International Sovereign Bonds (ISBs) were the main debt instruments used for financing the government's gross borrowing requirement in 2017.
- (b) An abridged table of activities under each source of funds is given below.

Table II-25
Instrument and Auction Performance
2016 and 2017

Instrument	2016		2017	
	Issuances Rs. billion	No. of Auctions	Issuances Rs. billion	No. of Auctions
Treasury bills	1,635.4	52	1,624.3	52
Treasury bonds	663.6	23	548.8	16
	Issuances USD million	No. of Auctions	Issuances USD million	No. of Auctions
Sri Lanka Development Bonds (SLDBs)	1,365.9	6	2,231.4	4
International Sovereign Bonds (ISBs)	1,500.0	1	1,500.0	1

- (c) Total net inflow of investments in T-bonds and T-bills by foreign investments in 2017 amounted to US dollars 440.6 million, which consisted of net inflow of US dollars 80.5 million in T-bills and US dollars 360.1 million in T-bonds.
- (d) The improved market conditions along with foreign inflows from International Sovereign Bonds, Syndicated Loans and increased foreign investments in T- bills and T- bonds combined with government strategy to settle only the principal amount of maturing T- bonds through domestic sources, enabled the secondary market yield rates to ease during the second half of 2017.
- (e) Average Time to Maturity (ATM) of the outstanding domestic debt stock declined to 5.78 years by end 2017 from 5.98 years by end 2016 due to reduction of longer tenure security issuances in view of tightened policy interest rate and liquidity environment.

21.2 Servicing of Government Debt

Domestic debt service payments of Rs. 1,213.5 billion and foreign debt service payments of Rs. 389.6 billion, totaling Rs. 1,603.1 billion was made during the year 2017.

21.3 Facilitation of the Settlement of Government Securities

LankaSecure system is used for settlement of primary and secondary market transactions in government securities. The system consists of 33 Dealer Direct Participants (25 licensed commercial banks and 8 primary dealer companies) maintaining accounts on their own behalf and on behalf of other investors who will be their customers and 3 direct participants (Colombo Stock Exchange, Central Bank of Sri Lanka and Employees' Provident Fund) who hold accounts on their own behalf only. PDD plays a main role in facilitating settlement by ensuring uninterrupted real-time operation of LankaSecure. The total face value of holdings in scripless securities as at end December 2017 amounted to Rs. 4,912.2 billion. This consisted of Rs.724.7 billion in T-bills and Rs. 4,187.5 billion in T-bonds.

21.4 Maintenance of the Registry in Government Securities

Facility for real-time updates in the Title Registry of government securities in the CDS, which is maintained at the PDD, has ensured safekeeping of government securities. Periodic statements to CDS account holders on their holdings, transactions and payments have been sent continuously throughout the year. PDD has sent 2,022 statements in electronic form and 18,962 semi-annual statements of holdings, 49,887 monthly statements of transactions and 24,029 payment statements by post to CDS account holders during 2017. In addition, CDS account holders are provided with the facility to view account details online. As at end December 2017, there were 93,203 registered CDS account holders.

21.5 System Reforms

In order to enhance the efficiency, effectiveness and transparency as well as to develop the government securities market, the following system reforms were undertaken during 2017.

(a) T-bonds new issuance process

Effective from July 27, 2017, the Central Bank introduced a new primary issuance system for T- bonds. The new system replaced the fully auction based issuance system for T- bonds that was in practice since February 2015. The main objective of introducing the new system was to further improve the efficiency of the process of funding the Government at least possible cost while maintaining the transparency of the financing arrangement. The new system includes regular monthly T- bond auctions. Each monthly auction offers two T- bond series of different maturities. Further, the new system is carried out in three phases. At Phase I, acceptance of all reasonable market bids within the offered amount under multiple price auction system is explored. Phase II involves a voluntary, volume based bidding for any under allocation in Phase I, vis-a-viz the offered amount. Issuance at this phase takes place at weighted average yield rates (WAYR) determined

at Phase I and the allocation is based on the successful performance of auction participants in Phase I, in the event of over subscription. At Phase III, the balance volume, if any, is issued on a mandatory basis at WAYR among Primary Dealers (PD). Allocation of Phase III is inversely proportionate to each PD's ratio of success at Phase I and Phase II. However, execution of Phase III could be made possible only when at least 60 per cent of the offered amount is accepted at Phase I.

(b) T-bill and T-bond Auction Calendar

PDD published a quarterly calendar for T-bills and T-bonds issuances incorporating the auction date, settlement date, tenor and amount information (for T-Bonds) during the year 2017. This is published in collaboration with the Ministry of Finance based on the financing requirements communicated to the PDD, to enhance the predictability of the primary auction process, to ensure availability of information to investors well in advance and to improve transparency.

21.6 Way forward

- (a) Explore the possibility of extending the new primary issuance system for T-bills as well to further improve transparency and efficiency of government borrowings from the domestic market.
- (b) Promote the secondary market for SLDBs, by issuing SLDBs in scripless form has been explored together with an electronic bidding arrangement for primary issuances.
- (c) To deepen and broaden the secondary market for government securities, preliminary measures have been taken to establish a distinct Electronic Trading Platform (ETP) and Central Counter Party (CCP) arrangement for government securities along with required legal reforms. Further, this will establish a mechanism to disseminate information on debt instruments in the secondary market with a view to enhance transparency and reduce asymmetrical information risk.
- (d) Institutionalisation of a Liability Management Framework
The enactment of the Liability Management Act (LMA) is at its latter stages of completion and is expected to come into force in early months of 2018. The Act is expected to institutionalise a formal framework for liability management measures for minimising rollover risk by altering the maturity profile of the outstanding debt stock, with the expectation to improve the underlying risk profile of the government debt stock, to manage the domestic and foreign debt, in a more cost and risk effective manner.

This will enable to proactively address part of the refinancing requirements ahead of time (reduce rollover peaks) and to extend the maturity duration

for commercial borrowings (ISBs). It is also expected to enable the extension of the maturity structure of T-bonds and the smoothing of the coupon payments cycle.

The LMA will provide the legal basis for active liability management initiatives such as buy-backs, switching and pre-funding arrangements. It will also enable to maintain special funds for the proceeds of sale of non-strategic assets.

- (e) Measures to strengthen the current legislations

Amendments have been proposed to improve the Registered Stocks and Securities Ordinance (RSSO) and Local Treasury Bills Ordinance (LTBO) to enhance transparency and to be on par with current market developments. Also, amendments have been suggested to Foreign Loans Act No. 29 of 1957 to be in line with international standards of accounting for external liabilities.

- (f) In order to enable diversification of the foreign investor base and to improve the ease of accessing the government securities market for foreign investors, PDD is in the process of exploring feasibility of Euroclearability of Government securities.

21.7 Coordinating Sovereign Rating Review Missions

In 2017, the PDD facilitated international rating agencies (Fitch Ratings Ltd., Moody's Investor Services, Standard & Poor's) for their annual rating reviews in order to ensure availability of international sovereign ratings for Sri Lanka.

22. REGIONAL DEVELOPMENT

Regional Development Department (RDD) embarked on developing and implementing new policy strategies in 2017, further expanding its operations of carrying out conventional credit operations. These new policy strategies and actions were able to strengthen the capacity of RDD as a whole to achieve its objectives of supporting inclusive and balance economic growth and promoting financial inclusiveness in the country.

During 2017, while providing a range of credit supplementary services, RDD continued to coordinate, facilitate and implement various refinance, interest subsidy and credit guarantee schemes. These concessionary credit schemes were funded by the Central Bank of Sri Lanka, Government of Sri Lanka (GOSL), Donor Agencies and Participating Financial Institutions (PFIs). RDD served individuals and business ventures in a wide spectrum of sectors including Agriculture and Animal Husbandry, Microfinance and Micro, Small and Medium Enterprise (MSME) sectors by providing affordable finance facilities. These beneficiaries, among other individuals in the target segments, were also benefitted from series of financial literacy and skill development programmes carried out by RDD throughout the year. RDD, with special focus on

those who have not accessed the formal financial sector, conducted comprehensive awareness building programmes island-wide to increase the level of financial inclusion. In this effort, the effective utilisation of print, electronic and broadcast media by RDD, was highly perceptible during the year.

From the policy perspective, 2017 was a challenging year for RDD as it embarked on introducing several loan schemes to serve different needy segments of the economy and initiating to develop a National Financial Inclusion Strategy (NFIS). During the year, several major projects of high national importance were strategised and implemented by the department utilising its human resources in the fullest capacity. These measures, inter alia, include establishing Partial Credit Guarantee (PCG) scheme, initiating the establishment of Smallholder Agribusiness Partnership Programme (SAPP) funded by the International Fund for Agriculture Development (IFAD), designing and implementing "Swashakthi – Towards One Million Jobs" loan scheme and two other loan schemes to provide concessionary finance to resume the disaster affected economic activities, namely, "Athwela" loan scheme and the "Post-disaster Economic Activity Recovery Loan (PEARL) scheme under the National Agribusiness Development Project (NADeP). Moreover, measures were taken to amend operating instructions of several loan schemes on need basis.

Further, recognising the importance of operating all stakeholders of the financial system in one direction to improve the financial inclusiveness, actions were initiated to obtain technical assistance of the International Financial Corporation (IFC) of the World Bank Group in developing the first-ever NFIS in the country, incorporating international exposure and experience.

22.1 Providing Concessionary Financial Facilities

With the intention of increasing financial outreach, RDD continued to expand the credit operations through 15 refinance loan schemes and interest subsidy schemes during 2017. Out of these schemes, three loan schemes, namely, "Swashakthi", "Athwela" and "PEARL" schemes, were introduced during 2017 with the intention of supporting government employment generation and post-disaster recovery efforts. Information on refinance loan schemes and interest subsidy schemes implemented by RDD, are given in Table II – 23. In addition, RDD established a PCG scheme under the Agriculture Sector Modernisation Project (AMP) which was funded by the World Bank in 2017 with the intention of facilitating to support increasing agriculture, and productivity, efficiency, improving market access, and enhancing value addition of the Agriculture sector in Sri Lanka.

During 2017, loans amounting to Rs. 19,251.03 million were disbursed among 126,742 beneficiaries through the PFIs of the Refinance loan schemes and interest subsidy schemes

implemented by RDD, enabling those beneficiaries to meet the challenges ahead with solid financial foundation and high self-reliance. Out of these disbursements, a majority of 57.7 per cent of loans were granted through the interest subsidy schemes while 42.3 per cent were disbursed through the refinance loan schemes. The funding requirements of these schemes were met by the IFAD, the Central Bank and the GOSL. These funding sources contributed to the loan disbursements of RDD by 47.0 per cent, 29.3 per cent and 23.8 per cent, respectively. When considering the sectoral composition of the loan disbursements, 73.0 per cent of loans were directed towards the Agriculture and Livestock sector, while 19.4 per cent and 7.6 per cent were delivered to the Industry sector and Services sector, respectively.

Status of the loan schemes implemented by RDD in 2017, is given below.

22.2 Implementation of GOSL funded Schemes

The GOSL continued to fund the loans and interest subsidy schemes of RDD by contributing Rs. 12,420.5 million or 23.8 per cent to the total loan disbursements in 2017. During the year, RDD implemented 8 schemes funded by the GOSL including 6 refinance loan schemes and 2 interest subsidy schemes. "Sarusara"- New Comprehensive Rural Credit Scheme (NCRCS) which is funded by the GOSL, served as a an interest subsidy scheme and a credit guarantee scheme as well.

- (a) Among the schemes funded by the GOSL, NCRCS displayed significant performance during 2017 by providing interest subsidy for 71,397 small-scale farmers of 33 short-term crop varieties. When considering the financial performance, NCRCS disbursed Rs. 7,845.2 million which accounted for 40.8 per cent of the total disbursements of RDD in 2017. Moreover, NCRCS alone, disbursed 63.2 per cent out of the disbursements made through GOSL funded schemes contributing to the development of the Agriculture sector of the country. However, NCRCS experienced a marginal decrease of 2.0 per cent in its loan disbursements compared to the previous year, due to the adverse weather conditions prevailed in the major cultivation areas in the country.
- (b) The geographical distribution of the loan disbursements of the NCRCS indicates Ampara District as the district which received the highest disbursements in 2017, which accounted to 12.6 per cent (Rs. 976.8 million) of the total disbursements under the scheme, breaking the continued trend experienced in the past. Anuradhapura District, which received the highest disbursements over the past, received 11.5 percent (Rs. 902.56 million) of the NCRCS disbursements as the second highest performing district. This was followed by Badulla district with 8.7 per cent (Rs. 684.9 million).
- (c) "Swashakthi" loan scheme, which was highlighted as the second highest performing government funded scheme

disbursed refinance amounting to Rs. 2,146.8 million for 9,664 beneficiaries in 2017. "Swashakthi" loan scheme was introduced in 2017 with the collaboration of the Ministry of National Policies and Economic Affairs (MNP & EA), considering the importance of having Government-led support mechanism to address financial, technical, marketing and entrepreneurship needs especially of youth and young graduates, women and differently able people. This scheme mainly focuses on the GOSL's broader policy objective of generating one million new jobs over the next five-year period.

- (d) This new loan scheme is intended to identify existing skills and talents of potential entrepreneurs and resources in the villages and provide them with necessary trainings and technical support together with marketing support to emerge as self-empowered micro entrepreneurs. The "Swashakthi" loan scheme is a credit plus scheme, which is operated island-wide. The unique feature of the Scheme is providing of special grant element for the new entrepreneurs in addition to the loan element to meet the initial expenses. The maximum amount of the grant is Rs. 50,000 and each entrepreneur is given a loan of maximum of Rs. 250,000 through PFIs at the interest rate of 5.5 per cent per annum. The recoveries of refinance principal will be revolved up to 20 years period.
- (e) Identifying the importance of government intervention in post-disaster economic activity recovery efforts, "Athwela" loan scheme was introduced in August 2017. The objective of this loan scheme is to provide concessionary financial facilities at 2 per cent per annum, to resume any economic activity affected by any disaster identified by the GOSL. As an initial step, GOSL allocated Rs. 2,000 million to provide financial facilities for the resumption of economic activities affected by the disasters prevailed in May 2017. As at end December 2017, after operating for nearly 4 months, RDD registered 4,570 loans amounting to Rs. 1,815.1 million. As per the records of the PFIs, loans amounting to a total of Rs. 887.8 million has been disbursed to 2,094 beneficiaries by the PFIs. At the end of 2017, RDD disbursed refinance totaling Rs. 100 million to the PFIs for 227 loans disbursed by the PFIs, upon their request.
- (f) Further, RDD implemented 4 other refinance loan schemes, namely, Poverty Alleviation Microfinance Project – Revolving Fund (PAMP-RF), Poverty Alleviation Microfinance Project II – Revolving Fund (PAMP II-RF), Self-Employment Promotion Initiative Loan Scheme – Phase II (SEPI – II), Tea Development Project -Revolving Fund and Working Capital Loan Scheme for Tea Factories (WCLSTF) which is an interest subsidy scheme. The PAMP-RF and PAMP II-RF refinance schemes collectively disbursed 12.7 per cent of the disbursements of the GOSL funded loan schemes, which accounted for Rs. 1,582.2 million. Out of the total GOSL funds disbursed during 2017, WCLSTF

disbursed Rs. 596.5 million, which is 4.8 per cent while "Athwela" and SEP-II loan schemes disbursed Rs. 249.7 million, which accounted for 2.0 per cent.

- (g) Majority of the funds allocated by the GOSL for the financing of these schemes were directed to the Agriculture and Animal Husbandry sector. A total of Rs. 9,997 million, which accounted to 80.6 per cent of the GOSL funding, was disbursed among the beneficiaries in the Agriculture and Animal Husbandry sector. 14.8 per cent of the funding was directed to the Industry sector (Rs. 1,838.0 million), which was followed by 4.6 per cent of disbursements made to the Services sector (Rs. 565.8 million) through these schemes funded by the GOSL.
- (h) In the policy front, the operation of the SEPI – II which is implemented with the objective of providing financial assistance to youth trained by recognized vocational training institutions for establishment of their own self-employment projects, was extended upto 31.12.2019 enabling the trained youth to enjoy its benefits for a longer period. The eligibility of the sub-borrowers under the SEPI-II was also amended to include both National Vocational Qualification Programme and Entrepreneurship Skills Development Programme, widening the outreach of the loan scheme. Moreover, the maximum period of loan repayment under SEPI – II, was also increased from 4 years to 5 years considering the positive impact it may have on young entrepreneurs.

22.3. Implementation of the Central Bank funded Schemes

In view of the strategic importance of regional development for balance and inclusive economic growth, In 2017, the Central Bank continued to fund two main schemes of RDD, respectively, the Saubagya Loan Scheme (SLS) and the Commercial Scale Dairy Development Loan Scheme (CSDDL), which is a refinance loan scheme and an interest subsidy scheme, respectively.

- (a) SLS as the principal refinance loan scheme implemented by RDD, disbursed Rs. 3,984.6 million which accounted for 43.5 per cent of the total funds disbursed through the Central Bank funded refinance schemes in 2017. During the year, SLS was able to serve 7,363 number of beneficiaries, island wide.
- (b) Compared to Rs. 4,767.1 million disbursed in 2016, the SLS experienced a 16.4 per cent decrease during the year 2017. This decrease is mainly attributable to the extent of fund availability of the loan scheme for 2017. However, out of available Rs. 4,000 million for the refinance disbursements, Rs. 3,984.6 million was disbursed during 2017. The introduction of "Swashakthi" loan scheme to promote employment generation in early 2017, at a low interest rate (5.5 per cent per annum), compared to the 8 per cent interest

rate of the SLS, served as an alternative source of financing for the beneficiaries of the SLS as well.

- (c) When considering the geographical distribution of the loan disbursements of SLS, continuing the trend in previous years, beneficiaries in the Kurunegala district have received the highest disbursements (13 per cent) under the scheme in 2017. This was followed by Kalutara district (10.7 per cent) and Gampaha district (9.5 per cent), respectively.
- (d) Majority of the disbursements of SLS, which accounted to Rs. 1,873.3 million (47.0 per cent) of the disbursements was directed to the Industry sector while Rs. 1,205.1 million (30.2 per cent) was disbursed among the beneficiaries of the Agriculture and Animal Husbandry sector. The residual of Rs. 906.2 million (22.7 per cent) was directed to other sectors.
- (e) CSDDLs, the interest subsidy scheme funded by the Central Bank operated during 2017 with the intention of providing financial facilities for the dairy entrepreneurs. Under this scheme interest subsidy is provided to the dairy farmers covering all aspects of activities related to dairy in order to support the national objective of achieving self-sufficiency in milk.
- (f) During 2017, CSDDLs disbursed Rs. 1,648.5 million among the dairy farmers of the country. When considering the overall performance of the loan and interest subsidy schemes implemented by RDD, CSDDLs was able to secure the fourth place contributing 8.6 per cent to the total disbursements.
- (g) Considering the collective performance, majority of the funds allocated by the Central Bank for the financing of these schemes were directed to the Agriculture and Animal Husbandry sector. A total of Rs. 2,853.61 million, which accounted to 50.7 per cent of the Central Bank funding, was disbursed among the beneficiaries in the Agriculture and Animal Husbandry sector. 33.3 per cent of the funding was directed to the Industry sector (Rs. 1,873.26 million) which was followed by 16.1 per cent of disbursements made to the Services sectors (Rs. 906.22 million).
- (h) From the policy perspective, with effect from February 2017, maximum repayment period of the loans granted under the CSDDLs was extended from 5 years to 6 years, inclusive of the maximum grace period of 1 year, depending on the nature of the dairy project. This policy measure was taken in response to the requests made by the stakeholders, considering the higher gestation period and the relatively longer period taken by the small-scale dairy farmers to transform into commercial scale.

22.4 Implementation of Donor funded Schemes

The contribution of the IFAD as a donor agency towards the regional development goals of RDD was significant

during 2017. IFAD contributed Rs. 1,197.5 million towards 6 refinance loan schemes in 2017 including 4 refinance loan schemes under the NADeP. More importantly, IFAD, upon the request of the GOSL, funded PEARL scheme under the NADeP to support the individuals affected by the disasters prevailed in 2017 in their post-disaster economic activity recovery efforts. During 2017, several policy changes were made with regard to the IFAD funded loan schemes, enabling their smooth functioning. The NADeP was concluded in December 2017.

- (a) In 2017, the loan schemes implemented under NADeP, namely, Microfinance, Tharuna Diriya, Out Grower Farmers (Capital and Seasonal loan schemes) and PEARL scheme have disbursed Rs. 1,040.5 million which was amounted to 86.9 per cent of the disbursements made under the loan schemes funded by the IFAD. Other than PEARL scheme, all other schemes directly served the beneficiaries in the Agriculture and Animal Husbandry sector.
- (b) Among NADeP loan schemes, Out Grower Farmers – Value Chain Development Loan scheme which consisted with two sub loan schemes, namely, Out Grower Farmers -Capital and Out Grower Farmers-Seasonal loan schemes, alone disbursed Rs. 437.7 million among its beneficiaries. This amount represented 42.1 per cent of the total disbursements made through NADeP during 2017. However, performing individually, NADeP microfinance loan scheme disbursed Rs. 334.1 million in 2017 which is 32.1 per cent of the IFAD funds disbursed throughout the year.
- (c) Upon the request of IFAD, several policy measures were taken with regard to the implementation of NADeP, during 2017. The loan size of “Tharuna Diriya” loan scheme was increased from Rs. 150,000 to Rs. 1 million while increasing its the period of loan repayment from 36 months to 48 months in order to accelerate employment generation and entrepreneurship development. Further, the period of operation of the NADeP was extended upto 31.12.2017.
- (d) In 2017, apart from NADeP, Dry Zone Livelihood Support and Partnership Programme - Revolving Fund (DZLiSPP – RF) which was implemented with the objective of poverty alleviation and income generation among the poor farmers in the districts of Monaragala, Kurunegala, Badulla and Anuradhapura was also concluded.
- (e) As in both GOSL and the Central Bank funded schemes implemented by RDD, majority of the funds disbursed through donor funded schemes were also directed to the Agriculture and Animal Husbandry sector which is for Rs. 1,183.5 million accounted for 98.8 per cent while the residual 1.2 per cent of

disbursements worth of Rs.14.0 million, was directed to the Industry sector.

- (f) In lieu of the NADeP, blueprints have been developed to introduce a new programme the Smallholder Agribusiness Partnership Programme (SAPP) in early 2018. The objective of SAPP is to sustainably increase the income and quality of diet of 57,500 smallholder households involved in commercially oriented production and marketing systems. SAPP is intended to create an inclusive formal financial service for its beneficiaries by providing them credit and other credit plus services. This programme will be funded by IFAD and the counterpart financing for SAPP will be provided by the GOSL. The Central Bank through RDD will act as the implementing agency for the credit component of the SAPP which will be consisted with 6 refinance loan schemes to cater the financial needs of the Agricultural and Animal Husbandry sector of the country.

22.5 Initiatives of RDD

(a) Agriculture Sector Modernisation Project (AMP) & the Partial Credit Guarantee (PCG) Scheme

With the intention of supporting enhanced agriculture productivity, efficiency, improving market access, and enhancing value addition by the all stakeholders, the AMP is implemented in Sri Lanka with the funding of the International Development Association (IDA) incorporating various organisational stakeholders into a single platform. The development objective of the AMP is to support increasing agriculture productivity, efficiency, improving market access, and enhancing value addition of formal farmers, farmer groups, smallholder producer organizations, cooperatives, companies, producer associations and agribusinesses SMEs in the project areas. The AMP is consists of three components, namely, Agriculture Value Chain Development, Productivity Enhancement and Diversification and Project Management, Monitoring and Evaluation.

Overall policy oversight, guidance and project monitoring for the AMP is expected to be given by the Central Project Coordination Committee established under the MNPEA. The implementing agencies for the AMP will be the Ministry of Primary Industries and the Ministry of Agriculture while the PCG Scheme under the Agriculture Value Chain Development component of the AMP, will be operated by RDD of the Central Bank, on behalf of the GOSL. The Director of RDD has been empowered with the authority to operate the PCG Scheme as the administrator.

The PCG Scheme, which is expected to act as an innovative risk sharing tool that mainly covers the PFIs against the risk of debt service default by sub-borrowers, will address the current and changing needs of financial intermediaries while supporting the development objective

of the AMP . In this context, PCG scheme is expected to leverage investments from formal farmers, farmer groups, smallholder producer organizations, cooperatives, companies, producer associations and agribusinesses SMEs for higher value agriculture production and value addition.

While addressing the issues faced by the farmers and agribusiness entrepreneurs with regard to the collateral requirements of PFIs in the process of funding their farming or business, PCG Scheme will address the issues of intermediary financial service providers in areas such as portfolio concentration risks and the capital requirements for cushioning against lending risks to the agriculture sector. Accordingly, the PCG scheme will focus on increasing access to finance, encourage PFIs to lend to the agriculture sector, covering part of the default risk of the PFIs and encouraging longer term lending for asset acquisition.

(b) Developing a National Strategy for Financial Inclusion

Identifying the importance of incorporating international exposure and experience to spur the financial inclusion in the country, the Central Bank sought out the technical assistance of the IFC, a World Bank Group member, to develop a comprehensive National Financial Inclusion Strategy (NFIS). Accordingly, in January 2018, the Central Bank signed a Cooperation Agreement with IFC in this regard.

The proposed NFIS is aimed to promote a more effective and efficient process to improve financial inclusion across the country. The technical assistance obtained from the IFC will provide an imperative opportunity to introduce an evidence-based, prioritised, better resourced, and more comprehensive approach to expanding access to financial services.

Through the implementation of the NFIS, it is expected to expand the retail payments infrastructure, encourage the use of a diverse set of financial services, improve consumer education, and to enhance the enabling environment for the provision of financial services, in short-run. Over the medium-term, the country will be able to achieve an inclusive financial system in which every adult and enterprise have access to, and are able to make full use of a range of adequate, quality, and affordable financial services.

22.6 Skills Development and Capacity Building

The imperative need for skills development and capacity building of the general public cannot be undermined by any principal organisation that intends to promote financial inclusion. RDD, having identified the paramount importance of developing effective strategies and delivering effective financial literacy and awareness, conducted 150 awareness

Table II-26
Lending Programmes Implemented by the Regional Development Department in 2017

Information on the Lending Programme/Concessionary Credit Scheme								Amounts in Rs. mn
Source of Funds	Name	Objective	Refinance/Interest Subsidy	Total Fund Allocation for 2017	Funds Disbursed to the PFIs in 2017	Balance Funds to be Disbursed	Interest Rate to the End Borrower – Year End (p.a)	Remarks
GOSL Funded	Poverty Alleviation Microfinance Project – Revolving Fund (PAMP-RF)	Poverty alleviation through promotion of income generating activities and organizing low income groups to link them with formal banking system.	Refinance	680.00	548.48	Recoveries will be revolved	12%	
	Poverty Alleviation Microfinance Project II Revolving Fund (PAMP II – RF)		Refinance	2,105.36	1,033.76	Recoveries will be revolved	10% from PFI to borrower 14% from OPA* to borrower	
	‘Swashakthi’ Loan Scheme	Generate employment opportunities, for both new entrants and existing entrepreneurs engaged in income generating activities MSME Sectors.	Refinance	4,000.00	2,146.78	1,853.22	5.5%	
	‘Athwela’ Loan Scheme for the Resumption of Economic Activities affected by Disasters (READ)	Providing concessionary financial facilities to resume any economic activity affected by any disaster as informed by the GOSL.	Refinance	2,000.00	100.00*	1,900*	2%	
	Self-Employment Promotion Initiative Loan Scheme (SEPI) Ph II	To provide financial assistance to youth trained by recognized vocational training institutions for establishment of their own self-employment projects	Refinance	150.00	149.68	Funds will be allocated for 2018 by the GOSL	7%	
	Tea Development Project -Revolving Fund (TDP-RF)	Increasing Tea smallholders’ income on a sustainable basis and developing the necessary infrastructure to meet the requirements of the export market by modernizing tea factories to obtain HACCP** certification.	Refinance	1,100.00	-	Concluded	9%	
	New Comprehensive Rural Credit Scheme (NCRCS)	Uplifting the socioeconomic conditions of micro and small-scale farmers who engage in cultivation of paddy and short-term crops.	Interest Subsidy & Credit Guarantee	Depends on the demand for funds.	7,845.22	N.A.**	7%	PFIs own funds and Interest Subsidy by GOSL
Working Capital Loan Scheme for Tea Factories	To assist the registered tea factories to meet their working capital requirements	Interest Subsidy	Depends on the demand for funds	596.53	N.A.**	(AWPLR +1.0%-2.0%)		
CBSL Funded	The prosperity Loan Scheme (“Saubagya”)	To start up or expand any micro, small and medium scale enterprise (MSME) or any MSME affected by disasters.	Refinance	4,000.00	3,984.59	Recoveries will be revolved	8%	
	Commercial Scale Dairy Development Loan Scheme (CSDDL)	Support to achieve self-sufficiency in milk and milk products through promoting commercial scale dairy farms.	Interest Subsidy	Depends on the demand for funds	1,648.50	N.A.**	6%	PFIs own funds and Interest Subsidy by GOSL
Donor Funded	National Agribusiness Development Project (NADeP) – Microfinance	To improve income level and social conditions of the poor in selected project areas.	Refinance	334.10	334.10	Concluded	6.5%	Funded by the International Fund for Agriculture Development (IFAD)
	NADeP – Tharuna Diriya	To reach village level poor youth to help improve their livelihood by providing them with credit facilities to start small business and other forms of self-employment projects making them entrepreneurs.	Refinance	268.80	268.80	Concluded	6.5%	
	NADeP – Out Grower Farmers (Capital and Seasonal Loan Schemes)	To increase the production, productivity, quality and value addition of agriculture produce.	Refinance	437.60	437.60	Concluded	6.5%	
	NADeP – PEARL Scheme	Providing concessionary financial facilities to resume any economic activity affected by disasters prevailed in the country in 2017.	Refinance	134.52	134.52	Concluded	6.5%	
	Dry Zone Livelihood Support and Partnership Programme - Revolving Fund	Poverty alleviation and income generation among the poor farmers in the districts of Monaragala, Kurunegala, Badulla and Anuradhapura.	Refinance	0.46	0.40	Concluded	10%	
	Small Farmers & Landless Credit Project – Revolving Fund (SFLCP-RF)	Channeling formal credit to income generating activities for the rural poor to improve the economic conditions and general welfare of beneficiaries.	Refinance	386.36	22.07	Recoveries will be revolved	12% -14%	

* As at end December 2017, after operating for nearly 04 months, RDD registered 4,570 loans amounting to Rs. 1,815.05 million under “Athwela” loan scheme. As per the records of the PFIs, loans amounting to a total of Rs. 887.78 million has been disbursed to 2,094 number beneficiaries by the PFIs.

** Abbreviations stands for;
HACCP : Hazard Analysis and Critical Control Points
N.A. ; Not applicable

programmes, mainly focusing on the financial literacy, entrepreneurship development and skills development, during 2017.

Not limiting to the developed urban areas, every effort was taken to reach the areas with low financial inclusion intending to create awareness on the drawbacks caused by financial exclusion. The programmes were customized to cater the requirements of the target audiences, fundamentally highlighting the rewards of entering and linking with the formal financial sector. Target groups of these programmes encompassed diversified set of individuals from different segments of the society. While creating awareness on the various concessionary loan schemes implemented by RDD, target groups were introduced to good banking habits, financial discipline and new financial instruments and services.

Details of the Programmes conducted by RDD are given in Table II - 27

Table II - 27
Awareness Programmes Conducted by
RDD during 2017

Type of Programme	No. of Programmes
Financial Literacy	74
Skills Development	57
Entrepreneurship Development	18
Media Campaign	1
Total	150

23. REGIONAL OFFICE MANAGEMENT

The Central Bank has established six Regional Offices (ROO) in terms of Section 7 of the Monetary Law Act, with a view to encourage and promote the development of the productive resources and to provide a better service to the general public. Accordingly, the Central Bank has established ROO in Matara, Anuradhapura, Matale, Trincomalee, Kilinochchi and Nuwara Eliya. At present, Regional Offices engage in coordinating financial institutions at regional level and conducting various training and awareness programmes, identifying viable economic activities in the respective regions and extending the Central Bank activities regionally.

23.1 Development Related Activities

During the year 2017, ROO engaged in various activities such as conducting awareness programmes, training and capacity building programmes to promote a more sustainable and balanced regional development with a view to reduce regional disparities. ROO were also actively engaged in conducting financial education and awareness programmes in the respective regions. ROO have conducted 234 awareness programmes on formal and affordable financial services, unauthorised deposit taking institutions/schemes, financial literacy and financial

inclusion programmes by targeting 21,928 individuals covering various segments such as students, undergraduates, public servants, entrepreneurs and the general public. Further, ROO promoted the credit delivery mechanism of the respective regions and successfully established 2,486 credit links. Credit counseling services were also provided to 2,309 borrowers who faced difficulties in repayment of their loan installments due to various reasons.

ROO also conducted several programmes covering the areas of entrepreneurship development, exposure visits/ technology transfer and best practices. Under this, 30 entrepreneurship development programmes benefitting 2,325 participants, 18 exposure visits/ technology transfer programmes benefitting 696 participants and 62 best practices programmes benefitting 3,053 participants were conducted through these programmes. Technology transfer, modern technology and best practices programmes were conducted by focusing on identified and viable economic sectors of each region such as dairy farming, floriculture, mushroom cultivation, food processing, garment sector, tourism related products and services etc. However, under this category, priority was given towards raising awareness and providing technology on various environment friendly projects. Further, 36 skill/ managerial development programmes were conducted for 1,765 individuals on developing and enhancing various skills.

A strong support was given to build up the SME sector in the relevant regions conducting 65 training programmes on various requirements to set up business ventures, marketing, accounting, taxation, book keeping, customer service and other formalities. A total number of 2,999 beneficiaries attended to those programmes. ROO also assisted borrowers in their marketing efforts through arranging market linkages, buyer-seller dialogues, trade fairs and exhibitions especially during the festive seasons. Accordingly, 14 trade fairs were organised at a regional level and a total number of 903 entrepreneurs were benefited.

RO – Matale organised an Open day programme namely, “Central Bank Comes to You...” in May 2017 and all the Central Bank related services such as EPF, exchange of damaged notes, currency museum, sale of the Central Bank publications and commemorative coins and information on various concessionary loan schemes etc. were carried out. RO – Kilinochchi in collaboration with Governors’ secretariat organised a special Governor’s visit to Jaffna and Kilinochchi in October 2017 to review and understand the issues faced by rural communities in the areas related to indebtedness and discussed the strategies to overcome indebtedness issues. ROMD, RO – Anuradhapura and RO – Trincomalee also participated in the Household Indebtedness Survey conducted in November 2017 in the North Central Province. Apart from the supervision and managing functions of ROO, Regional Office Management Department also initiated development activities in the

regions which are not covered by the ROO namely, Colombo, Kalutara and Gampaha. Accordingly, a special meeting was conducted with District Secretary, Kalutara in the latter part of the year establishing a relationship to understand specific requirements of training in the area.

23.2 Representing regional presence of the Central Bank

The six ROO represented the presence of the Central Bank at regional level by actively supporting to carry out various programmes of the Central Bank departments in the respective regions. ROO conducted several programmes during the year such as building countrywide awareness on clean note policy, identification of forged notes, unauthorised financial institutions, prohibited schemes, government securities market, foreign exchange regulations and conduct of educational programmes for students and teachers. During the year, there were 44 awareness programmes on clean note policy and forged note identification for 3,386 participants, 18 awareness programmes on unauthorised financial institutions and pyramid schemes for 2,276 participants, 32 educational seminars for 5,480 students and teachers, 11 awareness programmes on money laundering, terrorist financing and public debt for 1,313 participants, 04 awareness programmes on foreign exchange regulations for 413 participants, 24 awareness programmes on rules and regulations of the Central Bank lending schemes for 1,878 participants were conducted. ROO supported the Centre for Banking Studies of the Central Bank to conduct 15 training programmes in the regions for 1,209 staff members of the branches of Banks and Financial Institutions. Special attention was paid to provide various services to 79,476 EPF members island wide.

24. RISK MANAGEMENT

Risk management has become critical for all levels of decision making in the Central Bank, as the Central Bank is exposed to a number of risks in the course of carrying out its multi-faceted operations and dealings with internal and external parties. As such, managing risk in the Central Bank is carried out within a three lines of defense structure, where the responsibility of the first line of defense lies with the respective business owners or the departments. The second line of defense is the independent risk management function which is responsible for assessing, monitoring and reporting of financial risks. The third line of defense is the Internal Audit function that provides an independent, objective assurance to the Monetary Board on first and second line operations. As the second line of defense, the Risk Management Department (RMD) continued to perform its independent risk management function during the year, while taking initiatives to further strengthen the Risk Governance Framework in the Central Bank.

RMD has undertaken the tasks assigned to the department in a phase by phase manner. During the year, RMD

was mainly engaged in assessing, monitoring and reporting financial risks with respect to the foreign reserves investment, and investments by the internal funds managed by the Finance Department. In addition, RMD has taken initiatives to undertake risk management function pertaining to investments of Employees' Provident Fund (EPF) and worked on certain prerequisites required for moving towards an Enterprise-wide Risk Management (ERM) Framework.

The key functions performed by the RMD in 2017 are highlighted below.

24.1 Financial Risk of Foreign Reserve Investments

The main financial risks that the Central Bank is exposed to are market risk and credit risk. RMD was engaged in independently assessing, monitoring and reporting of market risk arising from the management of foreign reserves portfolio and ensured the compliance with Investment Policy and parameters specified in the Foreign Reserve Management Guidelines (FRMG). The market risk exposure of Fixed Income Security (FIS) portfolio was estimated by using Duration and Value at Risk (VaR), ensuring that risk levels were maintained within the specified targets.

Exposure to counterparty credit risk was monitored on a daily basis, based on credit ratings issued by Fitch Ratings, Standard and Poors' and Moody's Analytics. Accordingly, several counterparty exposure limits, issuer limits and product limits were revised during the year in line with rating changes, in accordance with the Counterparty Credit Risk Management Guidelines (CCRMG) to gauge the potential risk of default by counterparties and issuers in meeting their obligations. The RMD worked closely with the International Operations Department (IOD) in such a way to ensure that all investment transactions of the IOD were carried out within the limits structure assigned to eligible issuers and counterparties based on their respective risk levels.

Given that money market counterparties are more vulnerable to credit risk than those dealing with only FIS, movements of Credit Default Swap (CDS) spreads and Stock Market (SM) prices of active money market counterparties were evaluated on a daily basis categorizing their level of risk as High, Moderate or Low through corresponding traffic light indicators, Red, Amber and Green. These were informed to IOD facilitating them to take into account such information in investing in short term funds with the money market counterparties. RMD prepared monthly reports summarising CDS spread and SM price trends of money market counterparties and highlighted risk events in the international arena along with their potential implications, in order to identify new sources of risk.

RMD presented risk measurements and assessments pertaining to foreign reserves to Foreign Reserve Management Committee (FRMC) meetings on monthly basis, and submitted quarterly risk reports to the

BOX 13

Aligning Governance and Enterprise-wide Risk Management of Central Banks**Introduction**

Central Banks are conventionally viewed as risk-averse institutions. However, this notion is no longer valid as Central Banks have gradually become highly adept in recognizing the full range of risks confronted by them, and emerged as risk aware institutions rather than risk-averse institutions. This is on the grounds that Central Banks have undergone a series of transformations over the years, as reflected by the complexities of their operations. The present role of Central Banks has evolved to a more multifaceted mandate, which warrants them to take into account national interests, and other statutory and constitutional responsibilities, in addition to institutional risk and return considerations. On the external front, Central Banks across the globe operate in volatile, uncertain and unpredictable environments, where policy makers have to make an enormous effort to obtain reasonable assurance regarding effective management of risks within their own institutions. Additionally, due to Governance failures and scandals that have occurred in financial markets, public vigilance and expectations in relation to Central Banks have rapidly amplified, making these institutions extremely vulnerable to reputational risk. Hence, the loss of credibility through reputational risk now has a greater negative impact on the effectiveness of Central Bank policies.

In the given context, many Central Banks world-over have sought a reliable, structured and disciplined approach to risk management, and have chosen to adopt “Enterprise-wide Risk Management” (ERM) as an effective strategy to facilitate the management of existing and potential risks across an institution. ERM is essentially an integrated and holistic effort, where each and every stakeholder has a distinct role and responsibility for its successful execution. In this process, great importance is placed upon inculcating highest governance standards within the institution.

Governance in Central Banks

Governance in Central Banks is an issue that has been in the limelight for well over a decade, yet its effective application is debatable, due to real-life challenges confronted in putting sound governance into practice. Nevertheless, the strategic significance of this concept cannot be undermined, not only due to the many benefits it offers, but also since Central Banks preach and mandate regulated institutions under their supervision to adhere to governance guidelines imposed by them, giving rise to a moral obligation of the highest priority. Despite the issues coupled with its effective implementation, governance is viewed as one of ERM’s key pillars of success. Governance and ERM go hand-in-hand, complement each other, and benefit from each other.

Governance as a facilitator for ERM

Governance refers to how an organization is directed and managed, including the consideration and management of risk. Effective governance nurtures on the pillars of “Direction”, “Independence”, “Accountability” and “Transparency” and these are the basic prerequisites for the successful execution of an ERM Framework as well. The Board and the Senior Management must set the tone at the top, clearly indicating their commitment and direction with regard to Risk Management. The Risk Governance Framework must facilitate operational, functional and reporting independence wherever necessary. Accountabilities of all stakeholders under ERM must be predefined, including the role of the Board, committees, departments and individuals. Transparency in decision-making by the Board, committees and senior management must be ensured by establishing channels of communication with both internal and external focus. Determining clear reporting lines, decision structures, information flows, roles and responsibilities at the very beginning allow stakeholders of ERM to be more focused and efficient. It prevents unnecessary bureaucratic procedures and personal disagreements that lead to a delay in the implementation of ERM, waste of resources and disturbance of institutional harmony.

ERM as a facilitator of Governance

ERM helps understand uncertainties, highlights opportunities, prevents waste of effort, prioritizes activities and controls, and paves way for timely, informed, participative and risk aware decision-making. To safeguard the long-term viability and reputation of a Central Bank, the Board and the senior management must possess a shared understanding of risk. This is a vital feature of good governance, for which ERM is considered as an effective implementation mechanism. Literature on Central Bank governance reveals that there are many ways in which poor governance itself poses a threat to an institution. Few out of many such factors contributing to poor governance or governance risks are, the Board focusing on day-to-day management rather than on strategy; quality of information provided to the Board being inferior, delayed, inadequate or too voluminous; and not having a proper strategic plan for the institution or the plan in place being improperly executed. In addition, the Board being too small or large, lacking extensiveness, and complexity of required skills and knowledge; the Board being incompetent or disengaged, not having properly reviewed and approved policies and procedures in place, and risks being ignored or poorly managed are also considered as contributory factors to poor governance in Central Banks. The implementation of an effective ERM Framework would ensure that highest governance standards are in place and practiced within the institution.

The way Forward – Central Bank of Sri Lanka

ERM has received wide recognition from many Central Banks around the globe as it is considered a successful approach for managing risks, embedded with its key feature of the highest governance standards. Realizing the importance of adopting an effective Risk Management Framework within the Bank, in line with novel trends in Central Banking, “Implementing an ERM Framework within the CBSL” has been identified as one of the key strategic priorities of the Central Bank of Sri Lanka, in its Strategic Plan for 2018-2020.

The initial step in moving towards ERM involves the strategic implementation of a “Risk Governance Framework” within the Bank. In this regard, the CBSL has already formed a Risk Governance Framework, to be implemented in 2018, which consists of Risk Management and Risk Governance structures. The Risk Management Structure comprises the “three lines of defense” model for risk management. The three lines of the defense structure provides a clear demarcation of functions among three groups. The first line comprises business owners responsible for identifying, assessing and managing risks, ensuring that appropriate control activities are enforced and monitored for compliance. The second line comprises risk and compliance functions responsible for facilitation, independent oversight over risk and compliance related issues, and formulation of common risk, and compliance policies and guidelines. The third line comprises the audit function, which provides an independent, objective assurance to the Board on the effectiveness of first and second line operations. Each line of defense analyzes and presents risk related information from their own distinct perspective, allowing

the Board to develop a holistic view, assisting them to carry out decision-making in a well-informed, risk-aware manner, capitalizing on the combined assurance received under the new Framework.

The Risk Governance structure comprises a committee structure, which facilitates independent reporting, oversight and risk governance. Information to be reported to the Monetary Board flows through the Risk Governance Structure, which consists of an executive level risk committee and Board sub committees. These committees are established to facilitate participative decision making, while safeguarding objectivity and independence in information reporting and decision-making processes. The committee structure assists the Board to fulfill its governance and risk oversight responsibilities by having access to reliable, complete and timely information.

Conclusion

ERM has been recognized by Central Banks world-over as a highly effective mechanism for managing risks across institutions. It contributes to the attainment of institutional goals and objectives in a more collective and organized manner.

Nevertheless, even the best mechanism can fail, if implemented in an environment where governance is not given due prominence. Governance is essentially a prerequisite for ERM, and many Central Banks across the world, including the Central Bank of Sri Lanka have formed Risk Governance Frameworks, in order to lay a solid foundation for implementing them successfully, thus aligning Governance and ERM.

Monetary Board. In addition, the RMD evaluated new proposals relevant to foreign reserves investments, from risk management perspective and provided inputs for the preparation of Strategic Asset Allocation. During the year, RMD engaged in reviewing the existing FRMG and drafting Investment Policy Statement (IPS) for foreign reserves in line with developments under the World Bank Reserves Advisory Management Program (RAMP) and in line with ERM Framework to be implemented from 2018.

24.2 Internal Investment Funds

RMD was involved in analyzing investments of Internal Investment funds from a risk management perspective, and checking its compliance with the existing guidelines and giving recommendations for strengthening risk management practices wherever necessary. This analysis was carried out on a monthly basis and quarterly risk reports were submitted to the Monetary Board. RMD is in the process of developing the IPS and reviewing existing Investment Guidelines (IGs) in line with ERM Framework to be implemented in the Central Bank.

24.3 Employees’ Provident Fund (EPF)

RMD was also entrusted with the task of monitoring financial risks pertaining to investments of the EPF, and as an initial step towards this, RMD has conducted a study on the prevailing risk management framework related to the fund management activities of the EPF department and submitted its recommendations for further improvement of investment and risk management processes and procedures. RMD has already initiated reviewing of the existing IPS and Investment and Trading Guidelines (ITG) of EPF.

24.4 Initiatives for Moving towards an ERM Framework

As a further step towards strengthening the risk management function and risk management culture in the Central Bank, RMD made initiatives to establish an ERM framework for the Central Bank with the intention of implementing it during the strategic planning period of 2018-2020. At the annual strategic planning process of the Central Bank, ERM was identified as one of the key strategic priorities of the Central Bank, offering more weight and prominence to this task. RMD engaged in capacity building related to ERM,

by organizing workshops with the assistance of Centre for Banking Studies (CBS) with a view of inculcating risk culture within the Central Bank, and appointing risk officers for each department to coordinate with RMD regarding risk related matters, etc. During the year, RMD engaged in designing and developing a new Risk Governance Framework consisting of Risk Governance and Risk Management Structures which is considered as the basic foundation for an ERM to operate effectively in the Bank.

24.5 Non-Financial Risk

RMD prepared the Central Bank risk profile combining Non-Financial Risks pertaining to 17 Departments that are members of the Non-Financial Risk Management Committee. Identified risks have been classified under three main risk categories i.e. policy risk, operational risk and other non-financial risks and RMD developed and presented an analysis of these risks using the three by three risk matrix and risk categorising mechanisms.

24.6 Daily Market Information

RMD continued to escalate the daily analyses of market conditions to the Governor, which comprises of market liquidity conditions, short term interest rate movements in the domestic money market, cash flows and price changes in the international market with its impact on international reserves, yield curve behavior of government securities market and government borrowing requirements.

24.7 Other Activities

RMD concentrated on capacity building of the staff and in this regard, technical knowledge of the staff members was enhanced under the World Bank RAMP Program, which enables the RMD to further improve its work in line with internationally accepted standards. In addition, the departmental presentations by staff members helped in sharing knowledge apart from regular training programmes. Further, RMD staff was involved in updating the Treasury Management System administered by IOD, from a risk management perspective.

25. SECRETARIAT

Secretariat Department (SD) is one of the first departments established at the inception of the Central Bank. The main functions of SD are procurement of goods and services, administration of superannuation funds, implementation of leave rules, making payments pertaining to postgraduate studies, foreign trainings and foreign travels of the Central Bank staff, conducting the Board of Survey on obsolete and unserviceable equipment, organising events, providing mail room service, and provision of secretarial and protocol services to the Governor. These functions immensely contribute to the smooth operation of the Central Bank. As at end 2017, there were ninety one staff members attached to the SD.

(a) Procurement of Goods and Services

The SD procured capital and non-capital goods and services amounting to Rs. 107 million during 2017 mainly through tenders within the time schedule stipulated. In order to ensure timely supply of goods and services to the Central Bank, procurement planning was continued in 2017. As a result, SD was able to complete 87 per cent of the total procurement requirements of the Central Bank for the year. Further, SD obtained a cost-effective and comprehensive insurance cover for all properties, including the Public Liability Insurance.

(b) Administration of Superannuation Funds

SD continued to administer payments and other correspondence relating to the Central Bank Pension Scheme, Widows' and Orphans' Pension Fund, Widowers' and Orphans' Pension Fund and Central Bank Provident Fund, which involved over 2,000 beneficiaries.

(c) Implementation of Leave Rules

During 2017, SD arranged leave for 610 employees for private and official travels abroad. The SD handled correspondence relating to services provided to trade unions, clubs, associations and other organisations during the year.

(d) Making Payments pertaining to Postgraduate Studies, Foreign Trainings and Foreign Travels of the Central Bank Staff

During 2017, SD facilitated postgraduate studies of 45 employees and short term training of 477 employees.

(e) Conducting the Board of Survey on obsolete and unserviceable equipment, Organising Events and Providing Mail Room Service

During the year, activities relating to the Board of Survey was conducted at the Central Bank Head Office for the disposal of obsolete and unserviceable office equipment as per the procedure stipulated in the Central Bank Manual. In 2017, the SD coordinated and organised various commemorative events such as New Year Work Commencement Ceremony and Long Service Awards Ceremony, Programme to commemorate those who lost their lives at the bomb blast in 1996 and the 67th Anniversary Oration to mark the establishment of the Central Bank. The SD has also facilitated mailing of 58,515 letters and 1,051 parcels locally and internationally through its mail room service in 2017.

(f) Provision of Secretarial and Protocol Services to the Governor

During the year, SD provided secretarial and protocol facilities to the Governor. The secretariat assistance provided included the scheduling of appointments and meetings, preparation and compilation of presentations, speeches, notes, articles, etc., and provision of financial market information, media news and other reports. The protocol assistance included arranging Governor's local

and foreign travels and functions hosted by the Governor and the Deputy Governors and services provided to VIP visitors of the Governor and the Bank.

26. SECURITY SERVICES

Security Services Department (SSD) continued its operations to protect its employees, buildings, properties and currency consignments in transit during the year, while attending to system improvements and training of personnel, as summarized below.

26.1 System Improvements

Operational fitness of all fire-fighting equipments located at the Head Office and other outside premises was checked, repaired and replaced on a regular basis during the year. Initiative was taken to Implement a separate access control system to Sovereign Study Centre at CBS at Rajagiriya. SSD participated and co-operated in all business continuity drills conducted by Payment and Settlement and Information Technology Departments.

26.2 Training

(a) Fire Prevention, Fire Fighting and First Aid Programmes

A two day comprehensive training programme on fire prevention, fire fighting, first-aid and disaster management was conducted for fire-wardens selected from all departments of the Central Bank with the assistance of Fire Services Department of the Colombo Municipal Council, St. John Ambulance and Disaster Management Center. Further, a demonstration on fire fighting and fire-drills was conducted in March 2017 for all employees at the Head Office with the assistance of the Air Force and Colombo Fire Brigade.

(b) Skills and Competency Building

In order to improve the skills of the security officers, SSD arranged several educational programmes for its staff. These educational programmes covered the key areas of security, information technology, motivational attitudinal transformational aspects, customer relationships and leadership.

(c) Weapon Handling and Live Firing

Weapon handling and live firing were conducted for all security officers with the co-operation of the Sri Lanka Army during the last quarter of the year.

27. STAFF SERVICES MANAGEMENT

Staff Services Management Department (SSMD) continued to provide its welfare facilities to all beneficiaries in an effective manner throughout the year. These welfare facilities included provision of loans under the Staff Housing (Mortgage) Loan Scheme, Provident Fund Loan Scheme and Staff Benefit Scheme; reimbursement of expenses under the

Employer Contributory Medical Benefit Scheme (MBS) and provision of Medical Centre and Restaurant facilities. The number of registered beneficiaries under MBS consisting of employees, pensioners, their registered dependents together with widows/widowers was approximately 10,000 as at end 2017.

During 2017, SSMD granted 2,026 loans which included Housing Loans, Provident Fund Loans, Vehicle Loans, Computer Loans and other loans under the Staff Benefit Scheme. SSMD took measures to grant these loans within a stipulated time frame after receiving the application together with all relevant documents by the applicant. The loan monitoring system enabled effective supervision of loan disbursement to employees.

The Central Bank restaurant continued to improve its services for the Central Bank staff, to the possible highest quality. Further, measures were taken to improve the condition of the restaurants and restaurant facilities during 2017.

SSMD continued to reimburse medical expenses incurred by all registered beneficiaries under MBS. The total amount of reimbursement of medical expenditure increased by five per cent in 2017 compared to the previous year. A system was introduced to send an email notification to employees and retired employees informing the status of their claims to reimburse medical bills. The medical facilities at the Medical Centre were made available to the Central Bank employees during working hours by outsourcing such services. Medical tests and laboratory service facilities were also provided at the Medical Centre at a reasonable charge. During the year, SSMD conducted six awareness programmes to enhance the knowledge of the Central Bank staff on important health issues. Further, member fees and the limits of benefits of Death Relief Fund and Death Donation Scheme were revised in 2017.

28. STATISTICS

Statistics Department (STD) continued to contribute towards the achievement of the CBSL's objective of 'maintaining economic and price stability' by effectively performing its operations on collection, compilation, analysis, forecasting and dissemination of statistics. The major activities of the Department during 2017 included collection of data and information through surveys, research and other diverse sources; compilation of price, property and wage indices, and Sri Lanka Prosperity Index; estimation of Provincial Gross Domestic Product; forecasting of near term macroeconomic indicators and dissemination of statistics and other information through publications, press releases and a data repository. In addition, STD engaged in tracking Sri Lanka's position in global indices to contribute in improving country rankings and also in providing resources for capacity building initiatives for local and international organisations, during the year.

28.1 Collecting Data through Surveys and Other Data Sources

(a) Business Sentiment Surveys

Business Outlook Survey (BOS) was continued on a quarterly basis during 2017 to monitor current economic situation and to capture the short term market developments, which serve as the basis for future economic developments. The target population of this survey was large scale enterprises covering three major activities (Agriculture, Industry and Services) of the economy.

Purchasing Managers' Index (PMI) Survey for Manufacturing and Services activities was conducted on a monthly basis to use as early indicators in GDP forecasting. Further, such indices could be used by researchers, economic analysts, industry experts, business decision-makers as additional information to help better understand industry conditions. For PMI Survey for Manufacturing activities, the purchasing managers of the manufacturing industries and for PMI Survey for Services activities, suitable officers with an overall knowledge of the business activities of the firms were the target population. The survey was carried out during the last week of each month targeting responses from 100 institutions each from both Manufacturing and Services sectors of the economy predominantly concentrated in the Western province.

PMI Survey was extended to construction sector during 2017 to gain an insight into the developments in the construction industry by tracking different variables. The selection of the sample for this survey was based on the list of construction companies registered with the Construction Industry Development Authority (CIDA). The survey was conducted on a monthly basis from June 2017 in order to develop a high frequency indicator with the objective of strengthening the growth forecast related to the construction industry.

Credit Conditions Survey, which was designed to capture demand and supply side developments in the credit market, was also continued during the year 2017. This consists of a Credit Demand Survey to capture the demand side developments and a Credit Supply Survey to capture the supply side developments of the credit market. With regard to the Credit Demand Survey, the target population was obtained from the Small and Medium Enterprises (SMEs) of the economy in the Western province and in provinces in which the Central Bank has its regional presence. The Credit Supply Survey covers all Licensed Commercial Banks and Licensed Specialised Banks of the country. The results of Credit Conditions Survey were reported to the management on a semi-annual basis to facilitate policy formulation.

(b) Inflation Expectations Survey

Inflation Expectations Survey was conducted by the Department on a monthly basis since its introduction in 2006. The current survey includes three main categories of respondents;

Corporate Sector, Household Sector and the Academia, whereas the Academia was added to the respondent base during the latter part of 2017. STD completed the re-sampling process of the respondent base during 2017, particularly in the Corporate Sector. Respondents provided both quantitative and qualitative information on current inflation perceptions and inflation expectations for the period of 12 months ahead. The results of the survey on monthly basis were reported to the management to be used for policy decision making.

(c) Labour Force Information and Public Sector Employment Survey

With regard to overall labour market data analysis, information obtained from the Department of Census and Statistics (DCS) and other data providers, were analysed with respect to employment, unemployment, foreign employment, labour relations, labour market reforms and labour productivity in the country. Collaborative data sharing was carried out with national and international agencies in order to assist the policy formulation process.

Public Sector Employment Survey was conducted on a semi-annual basis covering all public sector institutions to ascertain the developments in the public sector employment. However, since the Department of Management Services (DMS) of the Ministry of Finance also conducts a similar survey, DMS has agreed to provide the required data pertaining to public sector employment at pre-decided intervals commencing from 2018. The data collected from the survey were published through the annual publications of the CBSL for the information of the general public.

(d) Private Sector Health Services Survey

STD has initiated this survey with the objective of introducing a new index to capture data on private sector health services to improve GDP forecasting. In this connection, a census targeting hospitals registered under Private Health Services Regulatory Council was first completed to enumerate the number of patients treated by private hospitals and medical centers in Sri Lanka as a part of the exercise to identify a suitable sample to represent the private health activities in the country. Based on the census results, a sample survey was conducted starting from second quarter of 2017 on a quarterly basis to collect monthly information on number of out-patients as well as admissions. This survey captures the developments in private health services as a volume indicator to forecast the value added growth in private sector health services.

(e) Super Market Retail Trade Survey

Identifying the future potential of modern retail trade activities of the country, the Department initiated a survey during 2017 targeting the key supermarket chains operating in the country. The objective of this survey was to compile a volume indicator that would help to track the trends in supermarket retail trade activities to be included as a new

indicator in STD's indicator based GDP forecasting. Further, it is expected to be used as a proxy to analyse consumer spending patterns of the economy.

(f) Condominium Market Survey

Since January 2017, a web based and a telephone based survey was conducted on a monthly basis covering major condominium property developers in the market, to collect advertised sales prices of condominiums, to identify the number of upcoming condominium units and to recognise the sales levels in both completed and ongoing projects. However, due to the unavailability of transacted prices and inability to identify the reasons for the price movements through these sources, STD decided to launch a questionnaire-based survey on a quarterly basis. Hence, towards the latter part of the year, initial arrangements were carried out to conduct the survey targeting condominium developers to collect information on actual sales prices, the demand, reasons for price changes, number of existing and upcoming housing units, level of occupancy in projects, buyer portfolio information and forward-looking perceptions of the developers. This information would assist in predicting the price trends providing insights for policy formulation purposes. A preliminary survey was launched in September 2017 and incorporating the feedback received from the participants, STD started the survey on a quarterly basis from 2018. Further, through this survey, the Department intends to maintain a close rapport with the market players in order to monitor the regular developments of the sector.

(g) Country Wide Data Collection System

A Country-Wide Data Collection System (CWDCS), which commenced in 1978, was continued during the year 2017 with regular collection of information on retail prices and producer prices of consumer goods, daily wages of the informal private sector and approximations on future production levels of agriculture and fisheries commodities on a weekly, monthly and quarterly basis. Data collected under the system are extensively used for analysing seasonal variations and regional differences in prices and wages; compilation of price indices, Provincial Gross Domestic Product and Sri Lanka Prosperity Index; forecasting price movements; evaluation of the impact of policy changes on prices; estimation of national expenditure and income; and dissemination of price and wage data to the general public.

Under the existing system, the data were collected through government school teachers, who serve as data investigators for data collection centres covering the island. Further, the system utilises services of non-teacher data investigators to report data on wholesale and retail prices from Pettah Market, Maradagahamula Rice Market, Dambulla and Narahenpita Special Economic Centers and Negombo and Peliyagoda Fish Markets on a daily and weekly basis. In order to strengthen the management information system,

the Department collected the wholesale and retail prices of a range of food commodities directly from selected markets as well and published for general information on a daily basis.

Initiatives were also taken during 2017 to revamp the existing CWDCS to a system of highly time bound data collection, transmission, aggregation and dissemination arrangement with high quality. The main objective of this process was to collect retail prices to facilitate forecasting of movements of National Consumer Price Index (NCPI) on time for policy making process. Seminars for training were conducted during the fourth quarter 2017 for the Teacher Investigators (TIs) network on the e-data collection arrangement under the new system. Tablet computers with a data collection Application (App) were introduced for all TIs together with hands-on-experience during these seminars. The electronic data collection platform under the upgraded system officially commenced on 01 January 2018.

28.2 Compiling Indices

(a) Business Sentiment Indices

Based on the results of BOS, Business Sentiment Indices namely; Business Condition, Profitability, Skilled Labour Availability, Sales, Demand and Capacity Utilisation were compiled. The results were presented to the MPC and a detailed report was submitted to the management for policy making purposes. Further, selected indices were published quarterly in aggregate form on the CBSL website for the information of the external users.

PMI Manufacturing with the sub-indices of New Orders, Production, Employment, Suppliers' Delivery Time and Stock of Purchases, and PMI Services with sub-indices of New Businesses, Business Activity, Employment, Backlogs of Work and Expectations for Activity were compiled assessing the month-on-month change and reported to the MPC and senior management for policy decision making and issued press notices for the general public.

(b) Property Price Indices

Compiling of the Land Price Index (LPI) was continued on a semi-annual basis during 2017 using valuation data obtained from the Valuation Department for 51 sub-divisions in Colombo, Dehiwala, Homagama, Kaduwela and Kesbawa Divisional Secretariat divisions. Three separate indices were compiled covering residential, commercial and industrial properties, while the overall LPI was the simple average of these sub-indices. In addition, STD has taken several initiatives to improve the coverage of real estate property indices by improving the existing indices both geographically and methodologically. Moreover, the land price report was published for the first time during 2017 for the information of the general public.

The Department has also initiated compiling a new index using the sales price information gathered through the web-based Condominium Market Survey. The index was compiled on a

monthly basis since January 2017, using publicly available information to monitor price movements in the condominium property market covering Colombo district and submitted for monetary policy purposes. The information obtained through the recently launched questionnaire-based Condominium Market Survey would enable to explain the movements of the existing index and to compile a new index based on the actual transacted prices.

(c) Wage Indices

STD compiled wage rate indices to assess the movements of salaries and wages in the economy. In this regard, the wage movements of the public, formal private and informal private sectors were analysed separately. Nominal and real wage rate indices for the public sector were compiled based on the public administration salary circulars. For the formal private sector, real wage rate indices were compiled using the nominal wage rate indices provided by the Department of Labour for the employees in the Wage Boards Trades. To address several shortcomings of the existing indices, STD commenced to compile a new index that represents wage trends of the formal private sector employees during 2017. Informal private sector wage movements were analysed in terms of the informal private sector wage rate index compiled based on information collected through CWDCS.

28.3 Forecasting Key Macroeconomic Variables

STD forecasts short term consumer price inflation and economic growth using model and non-model techniques. These forecasts were analysed and discussed at the Staff Level Meetings, Pre-MPC, MPC and submitted to the Monetary Board to facilitate policy decision making.

The short term inflation forecasts were mainly based on recent price trends, econometric techniques and expected price movements associated with market developments. The Department continuously explored new variables that reflect both supply and demand side impact on inflation to improve the inflation forecasting models. Moreover, the inflation forecasts were updated frequently in line with the realised and perceived changes in variables which impact inflation based on the movements of observed consumer prices, along with the developments in input and output prices as reflected through findings of surveys conducted by the Department.

Growth forecasts were prepared on a quarterly basis, using primary and secondary data related to each sub activity of the economy based on indicator as well as model based techniques. Leading economic indicators, survey findings and other information related to sub activities of the economy were combined with expert judgment for indicator based forecasts. In order to strengthen the model based short term forecasts, a short term Dynamic Factor Model was introduced during 2017 to its pool of techniques.

In addition to the in-house forecasting framework, STD continuously contributed to the Forecasting and Policy Analysis

System (FPAS) of the Central Bank, which was developed jointly with ERD under the technical assistance of IMF, with required short term forecasts of inflation and GDP, relevant analysis and other information.

28.4 Compiling Regional Statistics

(a) Sri Lanka Prosperity Index

To assess the overall status of prosperity in the country and in each of its provinces, STD continued to compile Sri Lanka Prosperity Index (SLPI) during 2017. This is a composite indicator reflecting the economic and social developments in the country and its provinces. SLPI comprises of three sub-indices namely; Economic and Business Climate, Well-being of the People and Socio-Economic Infrastructure, which are measured using 43 representative variables. In order to improve the representation of the country's overall prosperity, the Department is constantly exploring ways to improve the variables and methods of SLPI. Accordingly, during 2017 a new variable to measure the female participation among the provincial council members was included to the Socio-Economic Infrastructure segment, for strengthening the quality of the index.

(b) Provincial Gross Domestic Product

STD continued to estimate Provincial Gross Domestic Product (PGDP) in nominal terms by disaggregating the National Accounts estimates of the DCS, using relevant indicators at provincial level. The figures for 2016 and recompiled figures for 2015 were published in October 2017. The Department regularly explores suitable indicators at provincial level to distribute the national figures and improve the reliability of estimates. Composite indicators were also used, where appropriate, with the intention of gradually integrating most up-to-date statistics. Consequently, during 2017 modifications were introduced to the GDP line items relating to construction, wholesale and retail trade, financial services and insurance activities.

28.5 Dissemination of Information

During 2017, STD has taken a leap forward in data dissemination by launching the "Data Library" via the Central Bank website for the benefit of external data users. This was the further improved version of the electronic database, which was developed with the technical assistance from ITD to meet the internal data requirements. The database consists of time series data on a variety of areas spanning across Real, Monetary, Fiscal, External and Financial sectors collected from nine internal Departments and several external institutions.

Further, the Department released its two main annual publications namely; "Economic and Social Statistics of Sri Lanka 2017 – Volume XXXIX" and "Sri Lanka Socio Economic Data 2017 – Volume XL" in August and September respectively in all three languages in both printed and electronic forms. STD continued to publish Daily Price Reports of selected

consumer items, Weekly and Monthly Economic Indicators promptly via the Central Bank website during 2017. The Department contributed to two chapters of the Central Bank Annual Report and Recent Economic Developments report and provided data to the Monthly Bulletin of the Central Bank. Moreover, information was disseminated by way of press releases to the public at large and knowledge sharing exercises were also conducted throughout the year.

28.6 Tracking Sri Lanka's Position in Global Rankings

(a) "Ease of Doing Business" Ranking

The new working committee established in 2016 under the Ministry of Development Strategies and International Trade, which is now vested with the main responsibility of improving the "Ease of Doing Business" ranking of Sri Lanka, has articulated and published a roadmap for investment climate reforms with the technical assistance of the World Bank. Further, the committee is closely following up with the individual task forces on the progress of implementation the set reforms. In line with these initiatives of the government, STD continued to provide its assistance and hence, during 2017, the Department participated at various meetings/workshops conducted by the working committee to finalise the reform agenda; attended progress related meetings to provide the required inputs; coordinated Sri Lankan participation at International Seminars on improving country positions and disseminated information on a timely manner focusing on variables tracked under the ranking to the relevant authorities.

(b) Other Global Rankings

Global Indices namely; Worldwide Governance Indicators, The Global Competitiveness Index, Index of Economic Freedom, Human Development Index, Economic Freedom of the World Index, Corruption Perceptions Index, Enabling Trade Index and Country risk classification of Organisation for Economic Co-operation and Development (OECD) were monitored continuously and reports on country positions and strategies to improve rankings were submitted to the management and other higher authorities when required. Macroeconomic information and data were provided to the compilers of the above mentioned indices on a weekly and monthly basis.

29. SUPERVISION OF MICROFINANCE INSTITUTIONS

Department of Supervision of Microfinance Institutions (DSMI) was established with the responsibilities of regulation and supervision of the microfinance sector as stipulated by the Microfinance Act, No. 6 of 2016. Granting licence to Microfinance Companies that fulfill the minimum licensing requirements, regulation of the Licensed Microfinance Companies (LMFCs), continuous supervision of LMFCs and issuing Principles, Standards and Guidelines to the Registrar of Voluntary Social Service Organizations (RVSSO) to issue rules governing the Microfinance Non-Governmental

Organizations (MNGOs) are the major functions entrusted with the DSMI.

Nine applications were received by the end of 2017 for the licence under the Microfinance Act. Evaluation of the applications and conducting preliminary visits to the applicant companies were carried out during the year 2017.

Further, Principles, Standards and Guidelines on prudential requirements of the MNGOs were issued by DSMI to the RVSSO during the first quarter of 2017. RVSSO is required to give effect to those Principles, Standards and Guidelines through issuing of Rules governing the MNGOs.

(a) Awareness and Capacity Building

During the year 2017, DSMI conducted seven public awareness programmes island wide, in collaboration with the Lanka Microfinance Practitioners Association (LMFPA). The main objective of these programmes were to enhance the knowledge of microfinance customers and improve financial inclusion among them.

Further, three study visits were conducted by DSMI in Kilinochchi, Nuwara Eliya and Anuradhapura to identify issues related to microfinance sector, in order to recommend suitable policies.

30. SUPERVISION OF NON-BANK FINANCIAL INSTITUTIONS

Department of Supervision of Non-Bank Financial Institutions (DSNBFI) regulates and supervises, Licensed Finance Companies (LFCs) and Specialised Leasing Companies (SLCs) under the provisions of the Finance Business Act, No.42 of 2011 and the Finance Leasing Act, No.56 of 2000, respectively. In addition, DSNBFI is entrusted with the supervision of the Primary Dealers (PDs).

DSNBFI's supervisory function includes conduct of statutory examinations and continuous surveillance of the licensed entities while the regulatory function involves implementing prudential regulations and granting regulatory approvals. Apart from the major functions, DSNBFI also engages in several other activities such as investigating into companies alleged to be carrying on finance business without authority, conducting awareness programmes, capacity building of the sector, facilitating court proceedings and attending to public complaints.

As at end 2017, there were 45 LFCs, 6 SLCs and 15 PDs under the purview of the Department. In addition, licenses have been granted for 68 Registered Finance Leasing Establishments (RFLEs) under the Finance Leasing Act, which also includes SLCs. The names of these LFCs, SLCs, RFLEs and PDs are provided at the end of this section. The Directions and regulations issued during 2017 are given in Part III of this report. The main functions and activities performed by DSNBFI during 2017 are summarised below.

30.1 Supervision of LFCs and SLCs

(a) Conduct of Statutory Examinations

- i. As planned, DSNBFI conducted 30 annual statutory examinations of LFCs and SLCs during 2017. The main findings of the examinations included low efficiency, issues on corporate governance, inadequate loan loss provisioning, lapses in internal controls, potential credit risks and sustainability issues originated from the business models.
- ii. The Monetary Board approved time bound action plans and recommendations of these examinations, were communicated to the respective companies for attention of the Board of Directors and Board sub-committees and follow-up action was undertaken to ensure that LFCs and SLCs take corrective measures within the agreed time frames.

(b) Conduct of Continuous Surveillance

All LFCs and SLCs except for two LFCs which do not conduct business due to on-going liquidity issues of the companies, were continuously supervised based on periodic financial information submitted through the web based Finnet system. In view of improving the assessment process about the financial condition and identifying early warning signs of impending problems, a new continuous surveillance format was developed during the year. During the year, the Finnet return on branch distribution was revised to be in line with the newly issued direction on branch opening, relocation and closure while a new return was introduced to capture the financial information which is based on the new accounting standards. To further support the continuous surveillance, audited reports, management letters, external ratings and press reports were used. DSNBFI identified potential risk areas through an 'Early Warning System' and remedial actions were recommended to mitigate such risks. An internal supervisory rating system has also been implemented to rank LFCs based on their financial strength and risk management. The findings of the continuous surveillance and the sector performance were reported to the Monetary Board on a regular basis in view of keeping the senior management well informed of the latest developments in this sector.

(c) Resolution Actions on Weak LFCs

The key focus of DSNBFI during 2017 was to resolve the insolvent companies that has been confronted with prolonged liquidity crisis for the past several years. The Monetary Board granted approval in principle to liquidate three inactive distressed companies if a credible investment proposal could not be finalised. Accordingly, DSNBFI issued a notice of cancellation of the license issued to one company and currently is in the process of resolving the legal issues pertaining to liquidation. Out of the several proposals received by prospective investors for another company, the Monetary Board granted principle approval to implement the capital infusion plan proposed by an investor. For the other

company, DSNBFI continued to negotiate with potential investors while attending extensively on the court case filed by the depositors of the company. In addition, several steps were initiated against three active weak companies by facilitating several prospective investors to proceed with conducting due diligence for capital infusion and to restructure those companies. Further, restrictions on deposits and borrowings were imposed to two companies and regular meetings were also held with Board of Directors, Senior Management and External Auditors of these companies to monitor the progress.

30.2 Supervision of PDs

(a) Conduct of Statutory Examinations and Continuous Surveillance

Statutory examinations of 2 PDs were completed during 2017 while continuous supervision was carried out on all PDs. As supervisory measures, business activities of Perpetual Treasuries Limited (PTL) and Pan Asia Banking Corporation PLC – Primary Dealer Unit (PABC), were suspended for a period of six months (PTL w.e.f. 06.07.2017 and PABC w.e.f. 15.08.2017). Further, participation at Government Securities Primary Auctions was refrained for Entrust Securities PLC w.e.f. 24.07.2017.

Approval of the Monetary Board was granted to transfer the functions of supervision, examination and investigation and periodic evaluation of the performance of Bank PD Units to Bank Supervision Department with effect from 01.01.2018. Further, the Superintendent of Public Debt (SPD) was authorized to continue to issue regulations and directions to all PDs (non-bank PDs and bank PD Units) with respect to development of the Government Securities market and market conduct, while DSNBFI was empowered to issue directions and guidelines on prudential requirements for PDs.

(b) Resolution Action on Entrust Securities PLC (ESP)

A systematic concern arose in 2016 with respect to illiquid financial position as a result of the unsound financial practices of ESP. The secured repo and outright investments were settled and the FCID investigations are ongoing. The Monetary Board has granted approval for the implementation of the resolution mechanism proposed for ESP and accordingly, the resolution mechanism is under discussion.

30.3 Issuance of Prudential Regulation, Policy Formulation and Regulatory Approvals

(a) Issue of Directions and Prudential Requirements

i. Directions on Loan to Value Ratios for Credit Facilities in respect of Motor Vehicles

The directions issued to LFCs and SLCs on Loan to Value (LTV) ratio for credit facilities in respect of motor vehicles were revised in line with the National Budget proposal for the year 2017. Accordingly, maximum limits on LTV ratios are as follows.

Vehicle Category	LTV (%)
Unregistered vehicles and registered vehicles which have been used in Sri Lanka for less than one year after the first registration	
(i) Commercial vehicles (Lorries and Heavy Vehicles)	90
(ii) Motor Cars, Sports Utility Vehicles (SUVs) and Vans	50
(iii) Three wheelers	25
(iv) Any other vehicle	70
Registered vehicles which have been used in Sri Lanka for not less than one year after the first registration	70

The limits above were not applicable to credit facilities granted to any company engaged in tourism and/or transportation for purchase of vehicle fleets to be utilized for their core business operations, provided that such vehicles shall not be transferred to any person or entity within one year from the date of the first registration.

ii. Direction on Minimum Core Capital

The minimum core capital for LFCs was increased to be completed on a staggered basis in view of strengthening the capital position and increasing the capacity to absorb internal and external shocks. Accordingly, the minimum core capital was increased from Rs.400 million to Rs. 1.0 billion by 01.01.2018, Rs. 1.5 billion by 01.01.2019, Rs. 2.0 billion by 01.01.2020 and Rs. 2.5 billion by 01.01.2021.

iii. Concessions in respect of Credit Granted to Flood Affected Borrowers

LFCs and SLCs were allowed to grant the following concessions to borrowers which have been affected by floods, adverse weather conditions and connected circumstances in terms of the national policy adopted to facilitate rehabilitation of businesses and normal operations of such borrowers in the national interest.

- i. Grant a moratorium of not exceeding 3 months in respect of all performing credit facilities.
- ii. Waive off the penal interest on overdue loans of the borrowers under the above moratorium and non-performing borrowers as affected above who are willing to settle their loans on rescheduled terms to recommence/restructure their business activities.

iv. Work in Progress on Capital Adequacy and Customer Protection Framework

A new capital adequacy framework for LFCs and SLCs is proposed to be implemented during 2018 in view of fostering a strong emphasis on risk management and to encourage ongoing improvements in LFC and SLC's risk assessment capabilities. The draft Direction on capital adequacy framework has forwarded to the industry for their views/observations and thereafter the Direction will be issued in due course. Further, customer protection framework for LFCs and SLCs was finalised.

(b) Granting of Regulatory Approvals

- i. As part of the continuous surveillance, DSNBFI granted regulatory approvals to LFCs and SLCs to amend the Articles of Associations, form subsidiaries, issue debt instruments, increase share capital, capital infusions by new investors, outsource business operations, appoint new Directors and officers performing executive functions, change of registered address, relocation of business places, ownerships transfers and openings of 49 new branches.
- ii. During the year, two amalgamations were completed. That of Chilaw Finance PLC merging with Richard Peiris Finance Ltd. and Isuru Leasing Co. Ltd. merging with Central Finance PLC.

30.4 Investigation on Persons Carrying on Finance Business Without Authority

The Department was vigilant on the conduct of finance business without authority as per market information and public complaints. As at end 2017, there was one consultation done with the Honourable Attorney General on initiating legal action on an institution determined as carrying on unauthorised finance businesses.

30.5 Public Awareness and Capacity Building of the LFC and SLC Sector

(a) Public Awareness Programmes

DSNBFI conducted 8 public awareness sessions and broadcasted 10 electronic media advertisements with the view to educating the public on the risk of investing in unauthorized financial institutions and investments schemes. During the year, around 9,000 leaflets containing lists of Licenced Banks and LFCs with other useful information were distributed among the general public.

(b) Capacity Building of the Sector

DSNBFI conducted quarterly meetings with the Chief Executive Officers of LFCs and SLCs chaired by the Governor that served as a forum to sharing views between the Central Bank and companies on matters relating to the economy, LFC and SLC sector and regulatory developments. In addition, the Department held continuous meetings with LFCs and SLCs, external auditors and international agencies to discuss the company and sector related matters and to implement corrective actions. Further, the senior officers of the Department served as resource persons at the training sessions conducted at the Centre for Banking Studies of the Central Bank of Sri Lanka and regional offices.

30.6 Facilitating Court Proceedings on Unauthorised Financial Institutions

(a) Golden Key Credit Card Company Ltd. (GKCC)

With respect to the modalities approved by the Supreme Court for repayment to the Security Deposit Holders of GKCC in 3 tranches, GKCC is in the process of paying

Annex II-3	
Entities Regulated by DSNBFI (As at end 2017)	
Licensed Finance Companies	
1. Abans Finance PLC	24. Merchant Bank of Sri Lanka & Finance PLC
2. Alliance Finance Co. PLC	25. Multi Finance PLC
3. AMW Capital Leasing and Finance PLC	26. Nation Lanka Finance PLC
4. Arpico Finance Co. PLC	27. Orient Finance PLC
5. Asia Asset Finance PLC	28. People's Leasing & Finance PLC
6. Associated Motor Finance Co. PLC	29. People's Merchant Finance PLC
7. Bimputh Finance PLC	30. Richard Peiris Finance Ltd.
8. BRAC Lanka Finance PLC	31. Sarvodaya Development Finance Ltd.
9. Central Finance Co. PLC	32. Senkadagala Finance PLC
10. Central Investments and Finance PLC ^(a)	33. Serendib Finance Ltd.
11. Citizens Development Business Finance PLC	34. Singer Finance (Lanka) PLC
12. City Finance Corporation Ltd.	35. Sindhuputhra Finance PLC
13. Colombo Trust Finance PLC	36. Siyapatha Finance PLC
14. Commercial Credit and Finance PLC	37. Softlogic Finance PLC
15. Commercial Leasing & Finance PLC	38. Prime Finance PLC (formerly Summit Finance PLC)
16. ETI Finance Ltd.	39. Swarnamahala Financial Services PLC
17. HNB Grameen Finance Ltd.	40. The Finance Co. PLC
18. Ideal Finance Ltd.	41. The Standard Credit Finance Ltd.
19. Kanrich Finance Ltd.	42. TKS Finance Ltd.
20. L B Finance PLC	43. Trade Finance & Investments PLC
21. LOLC Finance PLC	44. U B Finance Co. Ltd.
22. Melsta Regal Finance Ltd.	45. Vallibel Finance PLC
23. Mercantile Investments and Finance PLC	
(a) Managed by the managing agent appointed by the Central Bank of Sri Lanka and undergoing restructuring. In the meantime, deposit mobilisation has been suspended.	
Registered Finance Leasing Establishments	
(A) Licensed Commercial Banks	
1. Amana Bank PLC	2. Lankaputhra Development Bank Ltd.
2. Bank of Ceylon	3. Pradeshiya Sanwardana Bank
3. Commercial Bank of Ceylon PLC	4. Sanasa Development Bank PLC
4. DFCC Bank PLC	5. Sri Lanka Savings Bank Ltd.
5. Hatton National Bank PLC	
6. MCB Bank Ltd.	(C) Specialised Leasing Companies
7. National Development Bank PLC	1. Assetline Leasing Co. Ltd.
8. Nations Trust Bank PLC	2. Co-operative Leasing Co. Ltd.
9. Pan Asia Banking Corporation PLC	3. LOLC Micro Credit Ltd.
10. Sampath Bank PLC	4. Newest Capital Ltd.
11. Seylan Bank PLC	5. SMB Leasing PLC
12. Union Bank of Colombo PLC	6. Unisons Capital Leasing Ltd.
(B) Licensed Specialised Banks	
1. Housing Development Finance Corporation Bank of Sri Lanka	(D) All Licensed Finance Companies listed above
Primary Dealers	
1. Acuity Securities Ltd.	9. Pan Asia Banking Corporation PLC ^(b)
2. Bank of Ceylon	10. People's Bank
3. Capital Alliance Ltd.	11. Perpetual Treasuries Ltd. ^(c)
4. Commercial Bank of Ceylon PLC	12. Sampath Bank PLC
5. Entrust Securities PLC ^(a)	13. Seylan Bank PLC
6. First Capital Treasuries PLC	14. Union Bank of Colombo PLC
7. Natwealth Securities Ltd.	15. WealthTrust Securities Ltd.
8. NSB Fund Management Co. Ltd.	
(a) Participation in government securities primary auction was refrained w.e.f. 24.07.2017	
(b) Suspended carrying on the business and activities of a primary dealer for a period of 6 months w.e.f. 15.08.2017	
(c) Suspended carrying on the business and activities of a primary dealer for a period of 6 months w.e.f. 06.07.2017	

the 3rd tranche. The Government has decided to release the 3rd tranche funds on an instalment basis and out of the total requirement of Rs. 4,055 million, Rs. 3,000 mn has been provided. The payments will be made to the balance depositors once the funds are received.

(b) Other Unauthorised Financial Institutions

The Department has continued to facilitate the proceedings of the court cases filed by the depositors of The Finance and Guarantee Property Developers Private Ltd. (FGPDL) and F&G Real Estate Company Ltd. (FGRECL) in 2015.

30.7. Handling of Public Complaints

DSNBFI mediated to resolve a large number of complaints received with regard to LFCs and SLCs from the general public mainly with respect to unfair customer practices and seeking reliefs on the transactions they entered into with LFCs and SLCs.

31. TRAINING AND DEVELOPMENT

The Training and Development Department (TDD) was established by the Monetary Board in July 2015 with the view of meeting the emerging needs of the human capital development of the Bank. Key functions of the TDD are identifying training needs and preparing strategies to fill training gaps, preparing and implementing annual training plan, facilitating intellectual capacity building, assisting staff for their postgraduate studies, providing opportunities for foreign/local short-term training for the staff and facilitating knowledge sharing among staff.

31.1 Postgraduate Studies

The TDD facilitated the staff class officers to pursue their postgraduate studies during 2017. Opportunities were given to 5 officers to embark on Doctor of Philosophy (PhD) programmes and 9 officers to commence their Master's degree programmes in reputed universities in Australia, UK and USA, while 1 officer to commence a PhD programme in a local university. Meanwhile, 6 officers who completed their PhD programmes and 18 officers who completed their Master's degree programmes resumed duties at the Bank during the year (Table II - 28).

31.2 Short-term Training

With the intention of minimising the competency gaps of the Bank employees, 1,572 short-term foreign and local training opportunities were provided to the Bank staff. These training gaps were identified through an annual competency mapping exercise carried out at the end of 2016.

31.2.1 Short-term Foreign Training

The TDD provided 308 short-term foreign training opportunities during the year by way of training programmes, workshops, seminars, conferences, study visits and meetings conducted by the reputed foreign training institutions and other central banks such as Bank of England, Deutsche Bundesbank, Reserve Bank of India, Bank Negara Malaysia, Bank of Korea and Federal Reserve System of USA and Monetary Authority of Singapore. The Bank staff also participated in training programmes offered by international funding agencies, research organisations, universities and training institutes such as International Monetary Fund (IMF), World Bank, Asian Development Bank, SEACEN, Bank for International Settlements (BIS), Indian Technical and Economic Co-operation (ITEC), University Putra Malaysia etc. The TDD facilitated 03 study visits held in Deutsche Bundesbank - Germany, APRACA - Bangladesh and Lanka Clear (Pvt) Ltd - India in 2017 (Table II - 29).

Table II - 29
Short-term Foreign Training - 2017

Field	No. of Programmes	No. of Participants
Monetary Policy, Economics and Statistics	51	74
Financial System Stability	71	96
Risk Management, Legal and Compliance	11	14
Portfolio Management	23	28
Central Banking	6	14
IT / Payments and Settlements	10	13
Currency Management	8	11
Human Resources Management	10	26
Microfinance	7	11
Other	12	21
Total	209	308

The effectiveness of the short-term foreign training received by the respective officers was continuously evaluated by way of assigning them various assignments to be carried out using the knowledge and the exposure gained through the training programmes. These activities were monitored by the training sub-committee on post training monitoring. Two training sub-committees were held during 2017. Accordingly, 27 assignments have been completed out of 34 by the officers who have participated in the short-term foreign training programmes in 2017 (Table II - 30).

Table II - 28
Number of Officers Who Commenced and Completed Postgraduate Studies under the Bank Scholarship Programme (2013-2017)

Studies	2013		2014		2015		2016		2017	
	Commenced	Completed	Commenced	Completed	Commenced	Completed	Commenced	Completed	Commenced	Completed
PhD	6	0	5	2	3	5	4	3	6	6
Master's Degree	11	19	24	11	19	21	15	18	9	18

Table II - 30
Completion of Assignments by Participants
of Short-term Foreign Training Programmes – 2017

Category	No. of Assignments
Guidelines for supervision of financial institutions	2
Knowledge sharing and public awareness through articles and presentations	16
Proposals for improving systems and processes	9
Total	27

31.2.2 Short-term Local Training

During the year, the TDD provided 1,264 short-term local training opportunities by way of training programmes, seminars, workshops etc. to the Bank staff at the Centre for Banking Studies (CBS) and at other reputed local institutions.

These were mainly in the areas of economics, statistics, accountancy, banking, IT, legal, auditing, fund management, risk management, secretarial practices, human resources development, supervision of banks & financial institutions, financial markets, foreign exchange, currency and regional development. The number of officers who participated in the training programmes conducted by the CBS and by other institutions were 756 and 508, respectively, during the year.

31.3 Workshops and Knowledge Sharing

The TDD organised a Structured High Level Training Programme on “International Trade and External Sector Issues” in 2017. In addition, the TDD facilitated the Central Bank officers to make presentations after returning from foreign training and reporting for duty after the postgraduate studies.