

# **PART II**

# PART II

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

	<b>Page</b>
1. Accounts and Finance	01
2. Bank Supervision	52
3. Centre for Banking Studies	56
4. Communications Library and Information Centre	57
5. Currency	59
6. Domestic Operations	61
7. Economic Research	64
8. Employees' Provident Fund	67
9. Exchange Control	71
10. Financial Intelligence Unit	75
11. Financial System Stability	77
12. Governor's Secretariat	78
13. Human Resource Management	79
14. Information Technology	84
15. International Operations	86
16. Management Audit	89
17. Payments and Settlements	90
18. Policy Review and Monitoring	94
19. Premises	95
20. Provincial Offices Monitoring	95
21. Public Debt	97
22. Regional Development	101
23. Secretariat	106
24. Security Services	107
25. Statistics and Field Surveys	107
26. Supervision of Non-Bank Financial Institutions	110
27. Welfare	115

## Report of the Auditor General

### CENTRAL BANK OF SRI LANKA Monetary Board Advisory Audit Committee Report

The Audit Committee (AC) appointed by the Monetary Board of the Central Bank of Sri Lanka (CBSL) consisted of three Members: Mrs. Mano Ramanathan, the Appointed Member of the Monetary Board (Chairperson of AC), Mr. M R Mihular (Partner KPMG Ford, Rhodes Thorton & Co) and Mrs. A M J Patrick (Partner SJMS Associates), Mr. P.D.J.Fernando (upto February 2010), Mr.B.D.W.A.Silva (upto March 2010) and Dr. W.M.Hemachandra (From March 2010), Assistant Governors, functioned as the Secretary to the Committee during 2010.

During the financial year 2010 the AC met 7 occasions and carried out the following tasks:

- Reviewed the draft final accounts of CBSL for 2009 prior to signing off by auditors & agreed on certain disclosures.
- Followed up issues highlighted by the External Auditors in their Interim Issues Memorandum (IIM) and Management Letter (ML) on the 2009 accounts of the CBSL.
- The following recommendations were made by the AC in relation to IIM and ML issues raised:
  - Disposing of the CBSL holdings in the Credit Information Bureau (CRIB) above 19.9% during the Q1-2010.
  - Defining a password policy for the Bank and apply to all the systems in the Bank.
  - Agreed not to adopt IFRS -9 early.
  - Observing the presentation of the actuary, carried out for 2010 actuarial valuations.
  - Carrying out a review on internal controls on financial reporting and to hiring an outside party to work with CBSL staff.
  - Taking a decision to record Lloyds Building, under Property Plant & Equipments
  - Subscribing to the IASB web service for all International Financial Reporting Standards (IFRS) updates.
- Made recommendations on the TOR for the selection of a firm of chartered accountants in developing a risk based auditing.
- Gave its concurrence to E&Y to carry out an additional assignment for IMF which was a requirement under the IMF Safeguards Assessment.
- Agreed with E & Y on the issues encountered in the audit for 2009 in the areas of reasonableness of the assumptions used for actuarial valuation, disclosure of bid value of local Treasury bill portfolio and Relevance of accounting policy disclosures relating to the revised IFRS and Improvements to IFRS.
- Recommended the non audit work to be assigned to the external auditors with the concurrence of AC to avoid any conflict of interest.
- Reviewed the presentation made by the Actuary.
- Approved the new Audit Charter and the Code of Ethics by the Management Audit Department and granted approval to proceed with the draft Terms of Reference (TOR) for the introduction of a Risk Based Audit Planning Methodology.
- Noted the recommendations made in the Quality Assessment Review Report prepared by Columbus Advisory Services Sdn Bhd together with the Institute of Internal Auditors (IIA), Malaysia on the Management Audit Department (DMA).
- Discussed the accounting issues on Market valuation of open position; Forex Deals, Security Borrowing, Gold as a non financial assets, Fair Valuation of loans granted under Provincial Credit Scheme, Accounting for Actuarial valuation of Employment benefit plans and Recognition of Actuarial gains/losses in the P&L, Deferring the cost of mopping up excess liquidity (as per MLA Sec 40), Disclosure of Related party transactions, Mandatory lending to Agriculture Sector, Mandatory Deposit Insurance Scheme, Revaluation of Land & Building and Investment property.
- Requested the Chairman of AC to inform the Monetary Board about staff rotation of the DMA as it is required to have trained staff and hence to reconsider the scheme of rotation of the staff when applied to DMA.
- Made recommendations on the quarterly progress reports of Director Management Audit.
- Instructed the Secretary to the AC on the frequency of AC meetings and reporting procedure, enabling timely reporting by AC to Monetary Board.
- Reviewed the progress of appointing the Auditor for the year 2011.

### Central Bank Of Sri Lanka Management Statement

For the period ended 31 December 2010

#### 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, a profitability related approach, if adopted by the Central Bank, could result in the Bank pursuing profits while compromising its core objectives, since it has the unique ability to create its own profits through its monetary policy activities, which could influence interest rates and exchange rates. It therefore follows that the Central Bank's objectives of economic and

price stability and financial system stability need to be distinguished and detached from the pure profitability objective which should essentially be incidental or academic only.

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

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



**විගණකාධිපති දෙපාර්තමේන්තුව**  
**கணக்காய்வாளர் தலைமை அறிபதி திணைக்களம்**  
**AUDITOR GENERAL'S DEPARTMENT**



මගේ අංකය } EF/J/CB/FA/2010  
எனது இல }  
My No. }

ඔබේ අංකය }  
உமது இல }  
Your No. }

දිනය } 29 March 2011  
திகதி }

**REPORT OF THE AUDITOR GENERAL**

The audit of the accompanying financial statements of the Central Bank of Sri Lanka (CBSL), which comprise the Statement of Financial Position as at 31 December 2010 and the Income Statement, Statement of Comprehensive Income, Statement of Changes in Equity and Statement of Cash Flows for the year then ended, and a summary of significant accounting policies and other explanatory notes thereto (Nos. 1 to 41) to the financial statements 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). The audit of the financial statements of the CBSL with regard to the compliance of International Financial Reporting Standards had been carried out by a firm of Chartered Accountants in public practice appointed by me.

**1.2 Responsibility of the Management for the Financial Statements**

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error, selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

**1.3 Scope of Audit and Basis of Opinion**

My responsibility is to express an opinion on these financial statements based on my audit. The audit was carried out in accordance with International Standards on Auditing. Those Standards require that the auditor comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatements. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatements of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal controls. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. I have obtained sufficient information and explanations which to the best of my knowledge and belief were necessary for the purpose of my audit. I therefore believe that my audit provides a reasonable basis for my opinion. Sub-sections (3) and (4) of the Section 13 of the Finance Act, No.38 of 1971 give discretionary powers to the Auditor General to determine the scope and extent of the Audit.

**1.4 Opinion**

I am of opinion, that the financial statements of the CBSL present fairly, in all material respects the financial position of the Bank as at 31 December 2010 and the financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

**1.5 Report to Parliament**

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

  
H.A.S. Samaraweera  
**Acting Auditor General**

නිදහස් වතුරලය,  
කොළඹ 07, ශ්‍රී ලංකාව

දුරකථනය } 2691151  
தொலைபேசி }  
Telephone }

கந்திரி சதுக்கம்,  
கொழும்பு 07, இலங்கை

ෆැක්ස් අංකය } 2697451  
பக்ஸ் இல }  
Fax No. }

INDEPENDENCE SQUARE,  
COLOMBO 07, SRI LANKA

ඉලෙක්ට්‍රොනික් තැපෑල } oaggov@slmet.lk  
# - பெயில் }  
E-mail }

## Central Bank of Sri Lanka Statement of Financial Position As at 31 December 2010

Assets	Note	2010 Rs. 000	2009 Rs. 000
<b>Foreign Currency Financial Assets</b>			
Cash & Cash Equivalents		189,664,726	147,871,157
Financial Assets:			
- Securities at Fair Value through Profit or Loss	5	183,729,813	56,275,323
- Available for Sale Investments	5	346,935,603	315,342,452
Other Foreign Receivables		8,534,829	2,429,319
IMF Related Assets	6	71,199,269	76,509,781
<b>Total Foreign Currency Financial Assets</b>		<b>800,064,240</b>	<b>598,428,032</b>
<b>Local Currency Financial Assets</b>			
Investment Portfolio - Sri Lanka Government Securities		20,497,816	43,450,557
Advances to Government	7	77,878,823	73,880,500
Loans to Other Institutions	8 (a)	2,459,846	1,136,596
Other Local Receivables	8 (b)	3,274,892	595,444
Investments in Financial and Other Institutions	9 (a)	41,236	43,855
Other Assets	9 (b)	1,272,621	1,497,973
<b>Total Local Currency Financial Assets</b>		<b>105,425,234</b>	<b>120,604,925</b>
<b>Total Financial Assets</b>		<b>905,489,474</b>	<b>719,032,957</b>
<b>Foreign Currency Non-Financial Assets</b>			
Securities Denominated in Gold		54,007,207	84,834,269
<b>Local Currency Non-Financial Assets</b>			
Inventories	10	2,814,784	2,157,200
Sundry Assets		4,170,077	4,092,428
Property, Plant and Equipment	11	9,344,340	9,342,947
Intangible Assets	12	17,753	16,383
Pension and Other Post Employment benefit plans	36	869,700	293,476
<b>Total Other Assets</b>		<b>71,223,861</b>	<b>100,736,703</b>
<b>Total Assets</b>		<b>976,713,335</b>	<b>819,769,660</b>
<b>Liabilities and Equity</b>			
<b>Foreign Currency Financial Liabilities</b>			
Amounts Payable to Banks and Financial Institutions	13	3,127,136	18,068,841
Amounts Payable to Asian Clearing Union	14	65,044,407	29,836,531
IMF Related Liabilities	15	275,420,837	218,171,021
Other Foreign Payable	16	5,014,191	5,008,035
<b>Total Foreign Currency Financial Liabilities</b>		<b>348,606,571</b>	<b>271,084,428</b>
<b>Local Currency Financial Liabilities</b>			
Deposits by Banks and Financial Institutions	17	104,853,445	86,085,866
Balances with Government and Governmental Entities	18(a)	3,088,659	2,347,709
Securities Sold Under Agreement to Repurchase	18(b)	113,454,891	84,022,645
Balances with Employee Benefit Plans	19(a)	977,154	1,050,255
Other Payables	19(b)	27,779,723	25,981,654
<b>Total Local Currency Financial Liabilities</b>		<b>250,153,872</b>	<b>199,488,129</b>
<b>Total Financial Liabilities</b>		<b>598,760,443</b>	<b>470,572,557</b>
<b>Other Liabilities</b>			
Currency in Circulation	20	255,652,217	217,429,835
Deferred Grants	21	4,605	567
Miscellaneous Liabilities and Accruals		74,381	66,895
<b>Total Other Liabilities</b>		<b>255,731,203</b>	<b>217,497,297</b>
<b>Total Liabilities</b>		<b>854,491,646</b>	<b>688,069,854</b>
<b>Equity</b>			
Capital Funds	22	25,000,000	25,000,000
Reserves		97,221,689	106,699,806
<b>Total Equity</b>		<b>122,221,689</b>	<b>131,699,806</b>
<b>Total Liabilities and Equity</b>		<b>976,713,335</b>	<b>819,769,660</b>

The Governor and the Chief Accountant of the Central Bank of Sri Lanka authorised these financial statements for issue on, 07th March 2011, for and on behalf of the bank :



.....  
Ajith Nivard Cabraal - Governor



.....  
M.I. Sufiyan - Chief Accountant

The accounting policies and notes on pages 07 through 51 form an integral part of the Financial Statements.

## Central Bank of Sri Lanka

### Income Statement

#### Year Ended 31 December 2010

		2010 Rs. 000	2009 Rs. 000
<b>Operating Income :</b>	<b>Note</b>		
<b>Income from Foreign Currency Financial Assets</b>			
Interest Income	24	10,841,880	4,595,856
Gain /(Loss) from Unrealized Price Revaluations		<u>(3,484,968)</u>	(4,177,107)
Gain /(Loss) Realized from Price Changes		<u>27,643,286</u>	<u>6,689,834</u>
<b>Total Income from Foreign Currency Financial Assets</b>		<b>35,000,198</b>	<b>7,108,583</b>
<b>Expenses on Foreign Currency Financial Liabilities</b>			
Interest Expense	25	<u>(3,881,159)</u>	<u>(1,832,436)</u>
<b>Total Expenses on Foreign Currency Financial Liabilities</b>		<b>(3,881,159)</b>	<b>(1,832,436)</b>
Net Foreign Exchange Revaluation Gain /(Loss)		<u>(8,659,222)</u>	<u>8,842,035</u>
<b>Foreign Currency Investment Income /(Loss)</b>		<b>22,459,817</b>	<b>14,118,182</b>
<b>Income from Local Currency Financial Assets</b>			
Interest Income	24	5,904,437	28,111,337
Interest Expense	25	<u>(10,123,663)</u>	<u>(2,534,820)</u>
<b>Total Income from Local Currency Financial Assets</b>		<b>(4,219,226)</b>	<b>25,576,518</b>
Other Income	26	<u>825,681</u>	<u>544,217</u>
<b>Total Net Operating Income /(Loss)</b>		<b>19,066,272</b>	<b>40,238,916</b>
<b>Operating Expenses:</b>			
Personnel Expenses:	27		
- Salaries and Wages		(2,224,931)	(2,128,264)
- Defined Contribution Plan Costs		(305,487)	(276,101)
- Additional Contribution to Post Employment Benefit Plan Costs		<u>262,190</u>	<u>-</u>
		<u>(2,268,228)</u>	<u>(2,404,365)</u>
Depreciation & Amortization		(278,453)	(295,759)
Cost of Inventory		(1,621,189)	(1,350,463)
Administration Expenses	28	(1,155,182)	(913,307)
Bad & Doubtful Debts and Net Sundry Write Offs		<u>(1,108,000)</u>	<u>-</u>
<b>Total Operating Expenses</b>		<b>(6,431,052)</b>	<b>(4,963,894)</b>
<b>Profit /(Loss) Before Income Tax</b>		<b>12,635,220</b>	<b>35,275,022</b>
Income Tax	29	<u>(891,267)</u>	<u>(1,636,373)</u>
<b>Net Profit /(Loss) for the Year</b>		<b>11,743,953</b>	<b>33,638,649</b>

The accounting policies and notes on pages 07 through 51 form an integral part of the Financial Statements.

**Central Bank of Sri Lanka**  
**Statement of Comprehensive Income**  
**Year ended 31 December 2010**

	2010 Rs. 000	2009 Rs. 000
Net Profit for the Year	11,743,953	33,638,649
Net Fair Value Gain / (Loss) on Available for Sale Securities	<u>(5,889,977)</u>	<u>(2,887,636)</u>
Total Comprehensive Income	<u>5,853,976</u>	<u>30,751,013</u>

The accounting policies and notes on pages 07 through 51 form an integral part of the Financial Statements.

**Central Bank of Sri Lanka**  
**Statement of Changes In Equity**  
**Year ended 31 December 2010**

	Reserves		Revaluation Reserve Rs.000	Other Reserves (Note 22) Rs.000		Retained Earnings Rs.000	Total Rs.000
	Contributed Capital Rs.000	Appropriated as Capital Rs.000					
<b>As at 01 January 2009</b>	15,000	24,985,000	2,706,067	68,891,661	24,351,065	120,948,793	
Net Profit	-	-	-	-	33,638,649	33,638,649	
Transfer to RTGS Sinking Fund	-	-	-	95,043	(95,043)	-	
Transfer to market valuation reserve	-	-	-	2,211,883	(2,211,883)	-	
Transfer of Net Foreign Exchange Revaluation Gain	-	-	-	8,842,035	(8,842,035)	-	
Transfer to CBSL Specific Reserve	-	-	-	269,798	(269,798)	-	
Other Comprehensive Income	-	-	-	(2,887,636)	-	(2,887,636)	
Transfer of Profit to Government	-	-	-	-	(20,000,000)	(20,000,000)	
<b>As at 01 January 2010</b>	<u>15,000</u>	<u>24,985,000</u>	<u>2,706,067</u>	<u>77,422,784</u>	<u>26,570,955</u>	<u>131,699,806</u>	
Net Profit	-	-	-	-	11,743,953	11,743,953	
Transfer to RTGS Sinking Fund	-	-	-	107,559	(107,559)	-	
Transfer to General Reserve	-	-	-	700,975	(700,975)	-	
Transfer to Market Valuation Reserve	-	-	-	(4,177,107)	4,177,107	-	
Transfer of Net Foreign Exchange Revaluation Gain	-	-	-	(8,659,222)	8,659,222	-	
Transfer to CBSL Specific Reserve	-	-	-	206,998	(206,998)	-	
Other Comprehensive Income	-	-	-	(5,889,977)	-	(5,889,977)	
Transfer of funds to CBSL Employees & Pension Disaster relief fund	-	-	-	-	(439)	(439)	
Transfer of balance Profit to Government - 2009	-	-	-	-	(5,000,000)	(5,000,000)	
Transfer of Profit in advance to Government - 2010	-	-	-	-	(10,000,000)	(10,000,000)	
Transfer of Funds invested under voluntary deposit insurance Scheme to Sri Lanka Deposit insurance Scheme	-	-	-	(331,653)	-	(331,653)	
Transfer Funds to Provincial Credit Scheme	-	-	-	2,900,000	(2,900,000)	-	
<b>As at 31 December 2010</b>	<u>15,000</u>	<u>24,985,000</u>	<u>2,706,067</u>	<u>62,280,356</u>	<u>32,235,266</u>	<u>122,221,689</u>	

The accounting policies and notes on pages 07 through 51 form an integral part of the Financial Statements.

## Central Bank of Sri Lanka

### Statement of Cash Flows

#### Year ended 31 December 2010

	Note	2010 Rs. 000	2009 Rs. 000
<b>Cash Flow from Operating Activities</b>			
<b>Source:</b>			
Interest Received - Foreign Currency		8,444,272	3,620,945
Interest Received - Local Currency - Others		401,620	452,164
Liquidity Management and Trading Income		27,643,286	6,992,342
Realised Exchange Gain / (Loss)		(2,150,718)	673,475
Other Income Received		657,674	468,899
		<u>34,996,134</u>	<u>12,207,825</u>
<b>Disbursements:</b>			
Interest Paid - Foreign Currency		3,695,818	1,963,574
Interest Paid - Local Currency		10,481,347	2,156,462
Payments to Employees		2,818,927	3,747,815
Payments to Suppliers		4,954,522	(21,256,640)
Income Tax Paid		884,633	1,857,983
		<u>22,835,247</u>	<u>(11,530,806)</u>
<b>Net Cash Flow from Operating Activities</b>	30	<u>12,160,887</u>	<u>23,738,631</u>
<b>Cash Flows from Investing Activities</b>			
<b>Source:</b>			
Net (Increase) /Decrease in Other Local Currency Financial Assets		(81,150)	(1,879,364)
Principal recoveries from the Loans and Advances to Other Institutions		791,117	2,688,756
Disposal /Redemption of Investments in Financial and Other Institutions		2,619	6,874
Sale of Property, Plant and Equipment		4,332	1,367
Income on Investments in Financial and Other Institutions		11,695	-
Net Increase /(Decrease) in Securities Purchased under Agreement to Re-sell		29,432,245	70,279,645
		<u>30,160,859</u>	<u>71,097,278</u>
<b>Disbursements:</b>			
Net Increase /(Decrease) in Foreign Currency Securities		183,338,571	286,976,540
Net Increase /(Decrease) in Other Foreign Currency Financial Assets		(1,800,539)	1,496,343
Net Increase /(Decrease) in Other Foreign Currency Financial Liabilities		(26,948,525)	40,717,160
Net Increase /(Decrease) in Other Local Deposits and Payables		(2,861)	4,290
Purchase of Property, Plant and Equipment net of Grants		280,027	387,795
Net Increase /(Decrease) in Gold Inventory		(29,680,126)	75,691,109
Loans and Advances granted to other institutions		1,954,823	2,203,105
Transfer of Deposit Insurance Fund Assets		331,653	-
		<u>127,473,023</u>	<u>407,476,342</u>
<b>Net Cash Flow from Investing Activities</b>		<u>(97,312,164)</u>	<u>(336,379,064)</u>
<b>Cash Flows from Financing Activities</b>			
<b>Source:</b>			
Issue of Circulating Currency		(260,277,179)	(218,514,268)
Withdrawal of Circulating Currency		298,499,562	249,845,187
Net Issue of Circulating Currency		<u>38,222,383</u>	<u>31,330,919</u>
<b>Less:</b>			
Net Withdrawals of Circulation Currency on Government Transactions	31	(25,210,557)	(147,556,788)
Net Withdrawals of Circulation Currency on Banks and Financial Institutions Transactions	32	(18,866,241)	(4,149,819)
Net Withdrawals of Circulating Currency		<u>(44,076,798)</u>	<u>(151,706,607)</u>
		<u>82,299,181</u>	<u>183,037,526</u>
<b>Disbursements:</b>			
Repayment of Foreign Currency Term Liabilities		(67,310,167)	(121,365,370)
Payments to Other Funds		439	-
Payments of Surplus to Government		15,000,000	20,000,000
		<u>(52,309,728)</u>	<u>(101,365,370)</u>
<b>Net Cash Flow from Financing Activities</b>		<u>134,608,909</u>	<u>284,402,896</u>
Net Increase in Cash and Cash Equivalents		49,457,633	(28,237,536)
Exchange Rate Effect on Cash and Cash Equivalents		(7,664,063)	8,769,887
Cash and Cash Equivalent at the Beginning of the Year		147,871,157	167,338,807
<b>Cash and Cash Equivalent at 31 December 2010</b>	33	<u>189,664,726</u>	<u>147,871,157</u>

The accounting policies and notes on pages 07 through 51 form an integral part of the Financial Statements.



## Central Bank of Sri Lanka

### Notes to the Financial Statements

#### Year ended 31 December 2010

#### 1. Reporting Entity And Statutory Base

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

These financial statements were authorised for issue by the Governor and Chief Accountant for and on behalf of the Monetary Board on 07 March 2011.

#### 2. Accounting Policies

##### 2.1 Basis of preparation

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

##### Reporting Format

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

##### Statement of Compliance

These financial statements of the Central Bank of Sri Lanka for the period ended 31 December 2010 have been prepared in accordance with International Financial Reporting Standards (IFRS). The financial statements prepared in accordance with the Monetary Law Act (MLA) are audited by the Auditor General

and gazetted as required by the law. Due to certain requirements in the IFRS, the classifications, and hence the amounts in the gazetted financial statements would be different from those in these financial statements.

##### Currency of Presentation

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

##### 2.2 Significant Accounting Judgments and Estimates

In the process of applying the accounting policies, the Bank has made the following judgments apart from those involving estimations, which have the most significant effect on the amounts recognized in the financial statements.

##### Impairment of Available for Sale Investments

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

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

The cost of defined benefit plans is determined using an actuarial valuation. The actuarial valuation involves making assumptions about discount rates, expected rates of return on assets, future compensation increases, mortality rates and future pension increases. Due to the long-term nature of these plans, such estimates are subject to significant uncertainty. Assumptions used are disclosed in Note 36.

##### 2.3 Changes in accounting policy and disclosures

The accounting policies adopted are consistent with those used in the previous financial year. Amendments resulting from improvements to IFRS to the following standards did not have any impact on the accounting policies, financial position or performance of the Bank.

- IFRS 2 Share-Based Payment : Group cash-settle share-based payment transactions effective 01 Jan 2010.

- IFRS 3 Business Combinations (revised) IAS 27 Consolidated and Separate Financial Statements (Amended) effective 01 July 2009, including consequential amendments to IFRS 2, IFRS 5, IFRS 7, IAS 7, IAS 21, IAS 28, IAS 31 and IAS 39
- IAS 39 Financial Instruments : Recognition and Measurement-Eligible hedge items effective 01 July 2009.
- IFRIC 17 Distribution of non cash assets to owners effective 01 July 2009.

### Improvements to IFRSs

Issued in May 2008

- IFRS 5 Non-Current Assets Held for sale and discontinue operations effective 01 January 2010.

Issued in April 2009

- IFRS 2 Share Base Payment
- IAS 1 Presentation of Financial Statements
- IAS 17 Leases
- IAS 38 Intangible Assets
- IFRIC 9 Reassessments of embedded derivatives

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

Standards issued but not yet effective up to the date of issuance of the bank's Financial Statements listed below. This listing is of standards and interpretation issued, with the bank reasonably expects to be applicable at a future date. The bank intends to adopt those standards when they become effective.

**IFRS 9 Financial Instruments** (effective from 1 January 2013) – IFRS 9 specifies the new requirement for classifying & measuring financial assets, which replace the IAS 39 Financial Instruments: Recognition and Measurement.

**IAS 24 Related Party Disclosures (Amendment)** - The amended standard is effective for annual periods beginning on or after 01 Jan 2011. It clarified the definition of a related party to simplify the identification of such relationships and to eliminate inconsistencies in

its applications. The revised standard introduces partial exemptions of disclosure requirements for government - related entities. The Bank does not expect any impact on its financial position or performance. Early adoption is permitted for either the partial exemption for government - related entities or for the entire standard.

**IAS 32 Financial instruments:** Classification and measurement - The amendment to IAS 32 is effective for annual periods beginning on or after 01 February 2010 and amended the definition of a financial liability in order to classify rights issues. (and certain options or warrants) as equity instruments in cases where such rights are given pro rata to all of the existing owners of the same class of an entity's non - derivative equity instruments , or to acquire a fixed number of the entities own equity instruments for a fixed amount in any currency. This amendment will have no impact on the bank after initial application.

**IFRS 9 Financial instrument:** Classification and Measurement - IFRS 9 as issued reflects the first phase of the IASBs work on the replacement of IAS 39 and applies to classification and measurement of financial assets and liabilities as defined in IAS 39. The standard is effective for annual periods beginning on or after 01 January 2013. Subsequent phases, the board will address impairment and hedge accounting. The completion of this project is expected in mid 2011. The adoption of the first phase of IFRS 9 will primarily have an effect on the classification and measurement of the bank's financial assets. The bank is currently assessing the impact of adopting IFRS 9 , however , the impact of adoption depends on the assets held by the bank at the date of adoption, it is not practical to quantify the effect.

**IFRIC 14 Prepayment of a minimum funding requirement (Amendment)** - The amendment to IFRS 14 is effective for annual periods beginning on or after 01 January 2011. With retrospective application the amendment provides guidance on assessing the recoverable amount of a net pension asset. The amendment permits an entity to treat the prepayment of a minimum funding requirement as an asset. The amendment is expected to have no impact on the financial statements of the bank.

IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments - IFRIC 19 is effective for annual periods beginning on or after 01 July 2010. The interpretation clarifies that equity instruments issued to creditor to extinguish a financial liability qualify as consideration paid. The equity instrument issued are measured at their fair value. In case this cannot be reliably measured, they are measured at the fair value of the liability extinguished. Any gain or loss is recognized immediately in profit or loss. The adoption of this interpretation will have no effect on the financial statements of the bank.

#### Improvements to IFRSs (issued in May 2010)

The IASB issued improvements to IFRSs, and omnibus of amendments to its IFRS standards. The amendments have not been adopted as they become effective for annual period on or after, either 01 July 2010 or 01 January 2011. The amendments are listed below.

- IFRS 3 Business Combinations.
- IFRS 7 Financial Instruments : Disclosures
- IAS 1 presentation of Financial Statements
- IAS 27 Consolidated and Separate financial Statements
- IFRIC 13 Customer Loyalty Programmes

The bank, however, expects no impact from the adoption of the amendments on its financial position or performance.

### 3. Summary Of Significant Accounting Policies

#### 3.1 Foreign Currency Conversions

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

Currency	2010 Rs.	2009 Rs.
1 Australian Dollar	112.8836	101.9909
1 Canadian Dollar	110.9031	109.2914
1 Euro	147.5619	163.7184
1 Japanese Yen	1.3611	1.2413
1 Special Drawing Rights (SDR)	170.8370	178.6670
1 Sterling Pound	171.4113	181.7454
1 United States Dollar	110.9530	114.3844

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

#### 3.2 Financial Assets and Liabilities

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

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

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

### Securities at Fair Value through Profit or Loss

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

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

### Foreign Currency Available-for-Sale Investments

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

Gains and losses arising from changes in the market value of foreign currency available-for-sale investments are recognised on a separate component of equity (shown under Other Reserves in the Statement of Financial Position) until the investment is sold, collected or otherwise disposed of, or until the investment is determined to be impaired, at which time the cumulative gain or loss previously reported as equity is included in income.

### Derivative Instruments

The Bank’s involvement in derivative instruments is mainly in forward foreign exchange contracts. Such derivative financial instruments are stated at fair value. The fair value of forward exchange contracts is calculated by reference to current forward exchange rates for contracts with similar maturity profiles. All derivative instruments in a gain or loss position, if any, are reported within the balance of foreign currency trading or available for sale securities in the Statement of Financial Position.

### International Monetary Fund (IMF) Related Balances

The Bank transacts with the International Monetary Fund (IMF) in its own right rather than as an agent for

the Government of Sri Lanka. All transactions by the Bank with the IMF have been included in these financial statements on that basis.

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

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

### Cash and Cash Equivalents

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

As a part of local currency activities CBSL generates certain income and incurs expenses, which do not involve in movement of cash. Those activities result in certain assets and liabilities and mainly comprise of the transactions with the Government of Sri Lanka (GOSL) and transactions with domestic banks and financial institutions. Transactions with GOSL include the purchase of un-subscribed portions of Treasury bills and bonds that are issued by the Government by the Bank as a monetary policy mechanism. Such purchases, disposals or interest thereon are reflected as mere book entries in the records of CBSL. These are disclosed separately in Note 31 and Note 32 to these Financial Statements.

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

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

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

#### **Repurchase and Reverse-Repurchase Transactions**

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

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

#### **CBSL Securities**

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

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

#### **Investment Portfolio – Sri Lanka Government Securities**

The Bank's investment portfolio consists of Treasury bills and bonds purchased from GOSL. The portfolio is recorded in the Statement of Financial Position at amortised cost since they represent loans provided to the GOSL.

#### **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.

#### **Loans to Other Institutions**

Loans granted to Other Institutions are recognised and carried at the original granted amount less an allowance for any uncollectible amounts. An allowance for doubtful debts (for loan impairment) is established if there is objective evidence that the Bank will not be able to collect all amounts due. The amount of the allowance is the difference between the carrying amount and the estimated recoverable amount. Bad debts are written off when identified.

#### **Securities Borrowings and Securities Lending**

Bank borrows Government Securities from time to time for 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.

#### **Impairment of Financial Assets**

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

#### **Assets carried at Amortised Cost**

If there is objective evidence that an impairment loss

on loans and receivables carried at amortized cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate

(i.e. the effective interest rate computed at initial recognition). The carrying amount of the asset shall be reduced either directly or through use of an allowance account. The amount of the loss shall be recognized in the Income Statement.

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

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

#### **Available-for-Sale Investments**

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

are reversed through profit or loss, if the increase in fair value of the instrument can be objectively related to an event occurring after the impairment loss was recognized in profit or loss.

#### **Foreign Currency Term Liabilities**

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

#### **Financial Guarantees**

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

#### **Other Financial Assets and Liabilities**

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

### **3.3 Other Assets and Liabilities**

#### **Gold**

Section 67 (1) of the Monetary Law Act which specifies the composition of the International Reserve indicates that gold may be held by the CBSL as part of this Reserve. Hence, CBSL holds Rs. 54 Bn in gold as part of its International Reserves as at 31 December 2010. As this gold is part of the International Reserve and not used as a commodity which is traded during the normal course of business, gold is fair valued and the gains or losses are transferred to the income statement. Prior to appropriation of profits, the unrealised gains or losses from gold are transferred to the relevant reserve account.

### Investments in Associates

The Bank's investments in associates, together with the ones that are held for subsequent disposals are accounted for under cost method.

### Inventories

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

### Property, Plant and Equipment

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

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

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

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

Valuations are performed frequently enough to ensure that the fair value of a revalued asset does not differ materially from its carrying amount.

Any revaluation surplus is credited to the Revaluation Reserve included in the equity section of the Statement of Financial Position, except to the extent that it reverses a revaluation decrease of the same asset previously recognized in Income Statement, in which case the increase is recognized in Income Statement. A revaluation deficit is recognized in Income Statement, except that a deficit directly offsetting a previous surplus on the same asset is directly offset against the surplus in the Revaluation Reserve. Upon disposal, any revaluation surplus relating to the particular asset being sold is transferred to retained earnings. An item of Property, Plant and Equipment is de-recognized upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on de-recognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the Income Statement in the year the asset is de-recognized. The asset's residual values, useful lives and methods are reviewed, and adjusted if appropriate, regularly.

### Intangible Assets

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

### Receivables

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

### Sundry Assets

#### Staff Loans

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

**Discount rate** - The rate compiled by the Economic Research Department of CBSL (ERD) based on the long term inflation target on USD –Commercial Interest Reference Rate (CIRR) plus 1 per cent added for the risk premium as agreed by the Audit Committee of the Bank is used as the discount rate and it varies with the period of the loans. (upto 15 yrs 11.22% and 15 to 30 years 8.91%)

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 earned by the Bank if these loans were granted at market rates.

#### **Assumptions used for computation of fair valuation**

- The staff loans granted from 2008 are considered.
- The date of staff loan granted is considered as 1st January.
- There were no amendments or settlements for these loans.

Other sundry assets are carried at expected realisable values.

#### **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.

#### **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.

#### **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.

#### **Pension and Other Post Employee Benefit Plans**

Pension and other Post Employment Benefit Plans operated by the Bank are disclosed in Note 36.

#### **Defined Benefit Plans**

The Bank operates defined benefit schemes for Pension, Widows' and Orphans' Pensions (W&OP), Widowers' and Orphans' Pensions (WR&OP), Retirement Gratuity and Post Employment Medical Benefits. The Bank and eligible beneficiaries make contributions, to separately administered funds in respect of the first three schemes. The cost of providing benefits under the defined benefit plans is determined separately for each plan using the projected unit credit actuarial valuation method. Actuarial valuations are carried out once in every three years

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

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



### **Defined Contribution Plans**

Employees are eligible for Employees' Provident Fund and 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.

### **Grants**

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

### **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.

### **Operating Leases**

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

### **Income Tax**

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

### **Revenue & Expenses**

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Bank and the revenue can be reliably measured. Expenses are recognised in the income statement on the basis of a direct association between the cost incurred and the

earning of specific items of income. All expenditure incurred in the running of the business and in maintaining the property, plant & equipment in a state of efficiency has been charged to income in arriving at the result for the year.

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

#### **Interest**

Interest income and expense are recognised in the income statement for all interest bearing instruments on an accrual basis using the effective yield method based on the actual purchase price unless collectibility 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.

#### **Dividends**

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

#### **Miscellaneous**

Miscellaneous income and expenses are recognised on an accrual basis.

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

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

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

All guarantees of indebtedness, forward foreign exchange transactions and other commitments, which

represent Off Statement of Financial Position items are shown under respective headings recognised as Off Statement of Financial Position items. Where applicable, such amounts are measured at best estimates.

#### 4. Nature And Extent Of Activities

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

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

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

#### 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 Newzealand 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.

#### Local Currency Activities

Local currency activities arise as follows:

- (i) 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.
- (ii) 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.

#### 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. Financial Assets

	2010 Rs. 000	2009 Rs. 000
Securities at Fair Value through Profit or Loss	183,729,813	56,275,323
Available for Sale Investments	346,935,603	315,342,452
<b>Total Financial Assets</b>	<b>530,665,416</b>	<b>371,617,775</b>

## 6. IMF Related Assets

	2010 Rs. 000	2009 Rs. 000
Holding in Special Drawing Rights	273,070	2,286,331
IMF Quota	70,624,016	73,860,938
Deposits with IMF	134,753	140,929
Pre Paid Commitment Fee	167,430	221,583
<b>Total IMF Related Assets</b>	<b>71,199,269</b>	<b>76,509,781</b>

### 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 honour various obligations connected with the operation of the SDR system. The IMF ensures that the SDRs claim on freely usable currencies is being honoured in two ways: by designating IMF members with a strong external position to purchase SDRs from members with weak external positions, and through the arrangement of voluntary exchanges between participating members in a managed market. The amount shown above represents the total holding of the Bank as at the respective Statement of Financial Position dates.

### IMF Quota

The International Monetary Fund (IMF) is an international organization of 187 member countries. It was established to promote international monetary cooperation, exchange stability, and orderly exchange arrangements; to foster economic growth and high levels of employment; and to provide temporary financial assistance to countries to help ease balance of payments adjustment. Quotas (capital subscriptions) are the primary source of IMF resources. The IMF receives its resources from its member countries. Each country's

subscription, or quota, is determined broadly on the basis of the economic size of the country, and taking into account quotas of similar countries. Upon joining the IMF, a country must pay 25 percent of its quota in widely accepted foreign currencies or SDRs, and the remaining 75 percent in its own currency.

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

**Voting power.** The quota defines a member's voting power in IMF decisions. Each IMF member has 250 basic votes plus one additional vote for each SDR 0.1Mn of quota.

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

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

IMF quota therefore represents an asset, and the bank transacting with the IMF in its own right rather than as an agent for the GOSL, reflects IMF Quota as an asset in its financial statements. The amounts payable in respect of the IMF Quota is shown under the heading Quota Liability in Note 15.

### PRGF-HIPC Trust Deposit

The PRGF – HIPC (Poverty Reduction Growth Facility for the Heavily Indebted Poor Countries) Trust Deposit was made under the agreement between the GOSL and the IMF on 21st April 2000 by transferring SDR 0.789 Mn from Sri Lanka's deposit in the post SCA-2 (Special Contingent Account) administered account with the IMF. This account was created under the guidance of the

IMF by transferring the balance held in SCA-2 against Sri Lanka when it was decided to wind up SCA-2 by the IMF. IMF requested the countries that had balances in the Post SCA-2 account to consider providing the balances in that account to the PRGF/HIPC trust either as outright grant or as a means of providing a subsidy for PRGF/HIPC Loan. Accordingly GOSL agreed to transfer the funds from Post SCA -2 accounts to PRGF/HIPC trust account, not as an outright grant, but as an interest free deposit until 2018.

## 7. Advances To Government

	2010 Rs. 000	2009 Rs. 000
Revolving Credit	<u>77,878,823</u>	<u>73,880,500</u>
	<u>77,878,823</u>	<u>73,880,500</u>

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

## 8. (a) Loans To Other Institutions

	2010 Rs. 000	2009 Rs. 000
<b>Capital Outstanding:</b>		
- Related Parties	1,758,574	45,919
- Others	<u>1,937,222</u>	<u>2,104,829</u>
	<u>3,695,796</u>	<u>2,150,748</u>
<b>Receivable under Susahana Tsunami Loan Scheme</b>		
- Related Parties	513,788	604,632
- Others	<u>214,058</u>	<u>512,558</u>
Interest Receivable	<u>4,217,766</u>	<u>4,217,766</u>
<b>Less:</b>		
Suspended Interest	(4,217,766)	(4,217,766)
Allowance for Doubtful Receivables	<u>(1,963,796)</u>	<u>(2,131,342)</u>
<b>Net Receivable</b>	<u>2,459,846</u>	<u>1,136,596</u>

Movement in Allowance for Doubtful Receivables is as follows:

	2010 Rs. 000	2009 Rs. 000
At the beginning of the year	2,131,342	2,178,492
Movement in allowance for doubtful debts Receivable	<u>(167,546)</u>	<u>(47,150)</u>
<b>At the end of 31 December 2010</b>	<u>1,963,796</u>	<u>2,131,342</u>

The aggregate amount of non-performing loans on which interest was not recognized amounted to Rs. 1,936.495 Mn as at 31 December 2010 (2009 Rs. 2,150.748 Mn). Unrecognised interest related to such loans amounted to Rs. 4,217.766 Mn as at 31 December 2010 (2009 Rs. 4,217.766 Mn).

## 8. (b) Other Local Receivables

	2010 Rs. 000	2009 Rs. 000
Receivable from Treasury & Other Ministries	2,377,257	63,194
Other Receivables	<u>897,635</u>	<u>532,250</u>
	<u>3,274,892</u>	<u>595,444</u>

Receivable from Treasury & Other Ministries represent the expenses incurred by the bank on behalf of the Government of Sri Lanka (GOSL).

## 9.(a)(i) Investments In Financial And Other Institutions

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

(ii) Based on the above requirements, the bank holds the following investments as at the statement of financial position date.

Investee	Business	% Holding	
		2010	2009
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	19.76	19.90
<b>Held For Sale</b> Credit Information Bureau of Sri Lanka Ltd	Provision of Credit Information	-	8.51

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

	2010 Rs. 000	2009 Rs. 000
Credit Information Bureau of Sri Lanka Limited	5,986	8,605
Lanka Clear (Private) Limited	29,500	29,500
Fitch Ratings Lanka Limited	3,500	3,500
Lanka Financial Services Bureau Limited	2,250	2,250
<b>Total Investments in Financial and Other Institutions</b>	<b>41,236</b>	<b>43,855</b>

#### 9. (b) Other Assets

	2010 Rs. 000	2009 Rs. 000
Other Local Assets	1,272,621	1,497,973
	<b>1,272,621</b>	<b>1,497,973</b>

During the year bank has transferred investments of Voluntary Deposit Insurance Scheme amounting to Rs. 331.653 Mn to Sri Lanka Deposit Insurance Scheme which was formed as per the gazette no: 1673/11 - 28 September 2010.

#### 10. Inventories

	2010 Rs. 000	2009 Rs. 000
Notes for Circulation	1,476,072	1,687,046
Coins for Circulation	513,981	391,615
Notes in Transit	668,170	-
Coins in Transit	144,914	68,587
	<b>2,803,137</b>	<b>2,147,248</b>
<b>Less:</b>		
Allowance for Slow Moving Items	(25,000)	(25,000)
	<b>2,778,137</b>	<b>2,122,248</b>
Stationery and Sundry Inventory	36,647	34,952
<b>Total Inventories at Lower of Cost and Net Realisable Value</b>	<b>2,814,784</b>	<b>2,157,200</b>

**11. Property, Plant And Equipment**

							Other		2010 Total Rs.000	2009 Total Rs.000
	Land and Buildings	Plant & Plant Integrals	Furniture & Equipment	Vehicles	Computers	Reading Materials	Construction In progress			
	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000			
<b>Cost</b>										
<b>As at 01 January</b>	8,367,062	1,061,420	604,440	214,713	662,793	38,248	244,763	11,193,439	10,817,079	
Additions	171,327	7,256	42,998	64,914	33,604	548	125,904	446,551	381,722	
Reclassification	-	(750)	25,176	-	(25,176)	750	-	-	-	
Disposals / Transfers	(3,546)	-	(3,927)	-	(911)	-	(171,327)	(179,711)	(5,362)	
<b>As at 31 December</b>	<u>8,534,843</u>	<u>1,067,926</u>	<u>668,687</u>	<u>279,627</u>	<u>670,310</u>	<u>39,546</u>	<u>199,340</u>	<u>11,460,279</u>	<u>11,193,439</u>	
Depreciation	Land and Buildings	Plant & Integrals	Furniture & Equipment	Vehicles	Computers	Reading Materials	Construction in Progress	2010 Total	2009 Total	
	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	
<b>As at 01 January</b>	253,847	373,512	435,156	169,231	592,379	26,367	-	1,850,492	1,575,031	
Depreciation for the year	123,279	53,048	41,251	26,589	24,111	1,221	-	269,499	279,455	
Reclassification	-	-	4,196	-	(4,196)	-	-	-	-	
Disposals	-	-	(3,141)	-	(911)	-	-	(4,052)	(3,994)	
<b>As at 31 December</b>	<u>377,126</u>	<u>426,560</u>	<u>477,462</u>	<u>195,820</u>	<u>611,383</u>	<u>27,588</u>	<u>-</u>	<u>2,115,939</u>	<u>1,850,492</u>	
<b>Net Book Value</b>	<u>8,157,717</u>	<u>641,366</u>	<u>191,225</u>	<u>83,807</u>	<u>58,927</u>	<u>11,958</u>	<u>199,340</u>	<u>9,344,340</u>	<u>9,342,947</u>	

The book values for land and buildings are recorded at fair value. The latest independent valuation was performed as at 31 December 2007 by P. B. Kalugalagedara (Chartered Valuer), which was recorded as at 31 December 2007.

Bank has purchased Property, Plant & Equipments and Intangible assets amounting to Rs 280.027 Mn in 2010 by payment of cash. (2009 – Rs. 387.795 Mn)

**12. Intangible Assets**

Composition of Land and Buildings is as follows:

	2010 Rs. 000	2009 Rs. 000
Freehold Land	2,939,202	2,942,747
Buildings on Freehold Land	5,138,725	5,078,799
Buildings on Leasehold Land	79,791	91,668
	<u>8,157,718</u>	<u>8,113,214</u>

The carrying amount of revalued land & building that would have been included in the financial statements had they been carried at cost less depreciation is Rs. 6,944.193 Mn (2009 Rs. 6,944.193 Mn).

The cost of fully depreciated assets of the bank as at 31 December 2010 amounts to Rs. 1,475.265 Mn. (2009- Rs.1,429.305 Mn).

**Computer Software:****Cost:**

As at 01 January	580,794	574,082
Additions	9,303	6,712
As at 31 December	<u>590,097</u>	<u>580,794</u>

**Amortisation and Impairment:**

As at 01 January	564,411	558,365
Amortisation Charge for the year	7,933	6,046
As at 31 December	<u>572,344</u>	<u>564,411</u>

**Net Book Value:**

As at 01 January	16,383	15,717
As at 31 December	<u>17,753</u>	<u>16,383</u>

### 13. Amounts Payable To Banks And Financial Institutions

	2010 Rs. 000	2009 Rs. 000
Payable to Foreign Banks	2,598,637	17,709,419
Payable to other Foreign Financial Institutions	528,499	359,422
	<u>3,127,136</u>	<u>18,068,841</u>

### 14. Amount Payable To The Asian Clearing Union

	2010 Rs. 000	2009 Rs. 000
Payable as at the end of the year	65,044,407	29,836,531
	<u>65,044,407</u>	<u>29,836,531</u>

The Asian Clearing Union (ACU) was established in 1974 under the auspices of the Economic and Social Commission for Asia and the Pacific as a mechanism for settlement of payments among participating countries' central banks. Sri Lanka is one of the participants. The other participants are Bangladesh, the Islamic Republic of Iran, Nepal, Pakistan, India, Bhutan and Myanmar. This is a clearing facility to settle, on a multilateral basis, payments for current international transactions among territories of participants. Net position as at end of each month is settled or received, after two-month credit period. Interest between 0.18 % and 0.21 % in USD (2009- 0.18% and 0.14%) & Interest between 0.28 % and 0.44 % in EUR (2009 - 0.28% and 0.30 %) is paid by net debtors to the facility and transferred to net creditors on daily balances outstanding between settlement dates. Above balance represents the amounts due to ACU at the respective Statement of Financial Position dates.

### 15. IMF Related Liabilities

	2010 Rs. 000	2009 Rs. 000
Interest Bearing Loans – Non Current	144,098,362	78,899,615
Interest Bearing Loans – Current	1,311,686	3,301,811
Allocation of Special Drawing Rights	67,559,235	70,655,689
Other Amounts Payable to IMF	38,802,123	41,627,642
Quota Liability	23,649,431	23,686,264
	<u>131,322,475</u>	<u>139,271,406</u>
<b>Total IMF Related Liabilities</b>	<u>275,420,837</u>	<u>218,171,021</u>

Interest bearing Loans consist of Poverty Reduction & Growth Facility (PRGF), Extended Fund Facility (EFF) as well as Emergency Assistance Facility (EAF) with the IMF.

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

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

#### Extended Fund Facility (EFF)

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

#### Emergency Assistance Facility (EAF)

The IMF provides an emergency assistance to member countries hit by natural disasters to help them meet immediate balance of payments financing needs and maintain or restore macro economic stability. The Executive Board of the IMF has approved SDR 103.350 Mn in emergency assistance for Sri Lanka. The emergency assistance will be repaid in eight equal quarterly instalments over 3 ¼ to 5 years from the disbursement date.

#### Stand By Arrangement (SBA)

The executive board of the IMF approved a 20-month stand by arrangement for Sri Lanka in an amount equivalent to SDR 1.65 Bn (USD 2.6 Bn) on 24th July 2009 to Sri Lanka as a balance of payment (BOP) support. On 28th July 2009 and on 10th November 2009 two tranches of the loan equivalent to SDR 413.4 Mn (USD 644.4 Mn) were received by Sri Lanka. On 30th June 2010 and on 28th September 2010 another

two tranches of the loan equivalent to SDR 275.6 Mn (USD 407.78 Mn) were received by Sri Lanka as 3rd and 4th tranches of the loan.

Subsequently, on 28th September 2010, the fifth tranche of the loan equivalent to SDR 137.8 Mn (USD 212.47 Mn) too was received by Sri Lanka.

The remaining amount will be phased in six tranches subject to quarterly reviews on economic performance of the country. The total loan facility made by the IMF equals 400 per cent of Sri Lanka's Quota.

Under the 20-month SBA Program, the final tranche will be disbursed in March 2012. The loan is repayable within 4 years commencing April 2013. The rate of interest of the SBA facility is composed of two components; the service charge and a fixed margin. The service charge is calculated weekly, based on the SDRs rate. The fixed margin is 1 per cent per annum for the outstanding loan amount up to 300 percent of the quota. When the outstanding loan amount exceeds 300 per cent of the quota, a surcharge of 2 per cent per annum is to be levied.

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

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

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

	Effective interest rate %	Maturity	2010 Rs. 000	2009 Rs. 000
<b>Current</b>				
EFF			-	307,754
EAF			-	685,903
PRGF 2	0.5		<u>1,311,686</u>	<u>2,308,154</u>
			<u>1,311,686</u>	<u>3,301,811</u>
<b>Non-current</b>				
SBA		2015	<u>141,248,032</u>	73,860,937
PRGF 2	0.5	2013	<u>1,967,530</u>	4,115,416
EFF	1.32	2013	<u>882,800</u>	923,262
			<u>144,098,362</u>	<u>78,899,615</u>
<b>Total Interest bearing Loans</b>			<u>145,410,048</u>	<u>82,201,426</u>

#### Allocation of Special Drawing Rights

The SDR is a reserve asset created by the IMF in order to meet a long-term global need to supplement existing reserve assets. SDRs are allocated to member countries in proportion to their IMF quotas. SDR allocations can only be made to countries that participate in the IMF's SDR Department (an accounting unit within the IMF). The IMF to supplement existing official reserve assets, such as gold holdings, foreign exchange, and reserve positions in the IMF, created SDRs. Under certain conditions, which are set in the Articles of Agreement signed on behalf of the Government of Sri Lanka by the Bank, the IMF may allocate SDRs to members in proportion to their IMF quotas. An allocation of SDRs by the IMF provides each member with a costless asset on which interest is neither earned nor paid. The Articles of Agreement also allow for cancellations of SDRs, but to date, this provision has not been used. Increases in Allocation of SDR represents increases in Holding of SDR as described in Note 6. Members of IMF shall be obligated to pay to the IMF an amount equal to its net cumulative allocation and any other amounts that may be due and payable because of its participation in the Special Drawing Rights Department at the point of termination or liquidation of IMF's SDR Department.

#### Other Amounts payable to IMF

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

#### Quota liability

The amounts payable in respect of the IMF Quota as described in Note 6 is shown under the heading Quota Liability.



**16. Other Foreign Payables**

	2010 Rs. 000	2009 Rs. 000
Other Foreign Liabilities	2,240,366	2,148,425
China Development Bank (CDB) Loan	2,773,825	2,859,610
	<u>5,014,191</u>	<u>5,008,035</u>

**China Development Bank Loan (CDB)**

CBSL entered into an Agreement with the China Development Bank (CDB) on 25th July 2009 to promote financial and economic co-operation between the two institutions. Under this agreement, CDB will make available a credit facility in an aggregate amount up to the commitment of USD 25 Mn and CBSL will apply the proceeds of the facility for the purpose of financial stability of the country enhancing liquidity of the market and promoting the development of agriculture, infrastructure in Sri Lanka.

Interest is calculated using the 6 months USD LIBOR plus a margin of 4%.

CBSL has to repay the facility in full on the final maturity date, the date falling thirty-six months after utilization date (14.08.2009).

**17. Deposits By Banks And Financial Institutions**

Under the mechanism of Real Time Gross Settlement System (RTGS), participants which include licensed commercial banks, primary dealers and the Employee Provident Fund, can obtain the required funds for honouring payments under an interest free, fully collateralized intra-day liquidity facility. The participants are required to pledge tradable government securities to obtain such intra-day liquidity facility. Advances under Intra-day Liquidity Facility represents such amounts advanced against tradable Government Securities, which stood at zero as at both year ends.

	2010 Rs. 000	2009 Rs. 000
<b>Deposits by Banks :</b>		
- Related Parties	55,282,083	36,556,496
- Others	49,563,846	49,525,894
	<u>104,845,929</u>	<u>86,082,390</u>
<b>Deposits by Financial Institutions</b>		
- Related Parties	368	132
- Others	7,148	3,344
	<u>7,516</u>	<u>3,476</u>
<b>Total Deposits by Banks and Other Financial Institutions</b>	<u>104,853,445</u>	<u>86,085,866</u>

**18. Balances With Government And Government Entities****(a) Total Balances with Government and Governmental Entities**

	2010 Rs. 000	2009 Rs. 000
Government Deposits	2,252,713	1,414,039
Government Agencies and Funds	835,946	933,670
	<u>3,088,659</u>	<u>2,347,709</u>

**(b) Securities Sold Under Agreement to Repurchase**

	2010 Rs. 000	2009 Rs. 000
Government Securities	18,400,000	6,000,000
CBSL Securities	95,054,891	78,022,645
	<u>113,454,891</u>	<u>84,022,645</u>

**19. (a) Balances With Employee Benefit Plans**

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

	2010 Rs. 000	2009 Rs. 000	Denomination	2010 Rs. 000	2009 Rs. 000
Employee Provident Fund	1,190	1,083	<b>Coins:</b>		
Employee Retirement Pension Scheme	(479,902)	(481,359)	1 cent	3,631	3,631
Widows' /Widowers' & Orphans' Pension Schemes	698,177	667,955	2 cent	5,702	5,702
Payable in respect of Gratuity Scheme	15,761	19,162	5 cent	23,245	23,249
Payable in respect of Medical Benefit Scheme	741,928	843,415	10 cent	39,212	39,220
<b>Total Other Deposits</b>	<b>977,154</b>	<b>1,050,255</b>	25 cent	121,120	120,754
			50 cent	185,633	184,190
			1 rupee	613,826	574,058
			2 rupee	863,079	811,255
			5 rupee	2,624,778	2,501,296
			10 rupee	645,699	447,287
			Commemorative coins	549,496	546,535
				<b>5,675,421</b>	<b>5,257,177</b>
<b>19. (b) Other Payable</b>			<b>Notes:</b>		
Other Payables includes Rs. 1,175.758 Mn (2009 – Nil) payable in respect of abandoned properties collected from the licensed banks & financial institutions under the Banking act directions no. 05 of 2009 – Identifying, Reporting, Transferring & Maintaining Abandoned Property of Licensed Commercial banks. In the event of any further claims on abandoned properties, bank is liable to pay deposits so collected with interest. Hence the total deposit collected with the interest calculated on weighted average T. Bill interest rate is recorded as a liability of the bank.			1 rupee	4,981	4,981
			2 rupee	26,699	26,699
			5 rupee	37,206	37,208
			10 rupee	1,856,521	1,806,776
			20 rupee	2,603,008	2,068,244
			50 rupee	3,568,411	3,052,438
			100 rupee	13,333,012	12,254,788
			200 rupee	210,389	176,231
			500 rupee	19,683,291	18,171,292
			1000 rupee	109,381,997	101,922,111
			2000 rupee	99,271,281	72,651,890
				<b>249,976,796</b>	<b>212,172,658</b>
			<b>Total Currency in Circulation</b>	<b>255,652,217</b>	<b>217,429,835</b>
<b>20. Currency In Circulation</b>			<b>21. Deferred Grants</b>		
The bank, as the sole currency issuing authority in Sri Lanka continued to perform the function of issuing legal tender currency. The amount of currency issued by the bank and in circulation at respective balance sheet dates are as follows:				2010 Rs. 000	2009 Rs. 000
			As at 01 January	567	-
			Grant Received	4,500	639
			Amortization during the year	(462)	(72)
			<b>As at 31 December</b>	<b>4,605</b>	<b>567</b>
			During the year the bank received a Vehicle from the Ministry of Finance without any consideration. The Asset was recognized in the financial statements at fair value with the corresponding credit recognized as deferred revenue. Deferred revenue is amortized over the period that matches with the depreciation policy of such assets.		

## 22. Equity

### Nature of Equity Items

#### Capital Funds

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

#### Reserves Appropriated as Capital

This Reserve is made up by transferring Rs.24,985 Mn out of the General Reserves in 2008, as per the Monetary Board decision of MB/F/22/12/2008.

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

**General Reserve** – The general reserve include amounts set aside by the Monetary Board in respect of the following reserves – Capital Contribution, Medium & Long Term Credits and Control Account Reserve. The Capital Contribution has been made to build up a fund for use of investment in finance and other entities.

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

**Net Fair Value/(Loss) on Available for Sale Securities and Allocated Gold Accounts** - For the year ended 31

December 2010, unrealized gains and losses on the revaluation of securities designated as available for sale & on allocated gold accounts, have been transferred to this reserve

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

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

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

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

**Deposit Insurance Fund** - Investments representing the fund created for Voluntary Deposit Scheme, administered by the bank have been paid out to the Sri Lanka Deposit Insurance Scheme subsequent to the establishment of the same as per the gazette notification 1673/11- 28 September 2010 (Note 40- c,e). The amount of the fund so transferred was Rs. 331.653 Mn.

The movements in the other reserves are as follows:

	Medium and Long Term Credit Reserve Rs. 000	Market Valuation & Other Reserves Rs. 000	CBSL Specific Reserves Rs. 000	RTGS Sinking Fund Rs. 000	IRR	Net Fair Value/ (Loss) on Available for Sale Securities Rs.000	Pension Fund Reserves Rs.000	Technical Advancement Reserves Rs. 000	Provincial Development Credit Scheme Fund Rs. 000	Total Rs. 000
<b>As At 1 January 2010</b>	9,425,000	16,568,574	742,992	297,907	47,453,545	(1,065,235)	3,000,000	1,000,000	-	77,422,784
Transfer of RTGS Income to RTGS Fund	-	-	-	107,559	-	-	-	-	-	107,559
Transfer of CBSL Specific Reserve	-	-	206,998	-	-	-	-	-	-	206,998
Transfer of Profits to General Reserve	-	700,975	-	-	-	-	-	-	-	700,975
Transfer of Profits to Market valuation Reserve	-	(4,177,107)	-	-	-	-	-	-	-	(4,177,107)
Transfer of Net Foreign Exchange Revaluation Loss	-	-	-	-	(8,659,222)	-	-	-	-	(8,659,222)
Net Fair value Loss on Available for sale Securities & gold	-	-	-	-	-	(5,889,977)	-	-	-	(5,889,977)
Transfer of funds to provincial credit scheme	(2,900,000)	-	-	-	-	-	-	-	2,900,000	-
Replenishment of MLTC for the Transfer made to provincial Credit scheme	2,900,000	-	-	-	-	-	-	-	-	2,900,000
Transfer of Funds invested under voluntary deposit insurance scheme to Sri Lanka deposit insurance scheme	-	-	(331,653)	-	-	-	-	-	-	(331,653)
<b>As At 31 December 2010</b>	<b>9,425,000</b>	<b>13,092,442</b>	<b>618,337</b>	<b>405,466</b>	<b>38,794,323</b>	<b>(6,955,212)</b>	<b>3,000,000</b>	<b>1,000,000</b>	<b>2,900,000</b>	<b>62,280,356</b>

### 23. Transfer Of Net Profits

Under section 39 (c) of the Monetary Law Act No. 58 of 1949, as amended, the bank's net profit, as determined in accordance with the Act, is paid to the government after making necessary appropriations to Reserves under section 38 of the Monetary Law Act. During the Period bank transferred Rs. 5 Bn in respect of 2009 profits & Rs.10 Bn in respect of 2010 profits, to the government.

### 24. Interest Income From Financial Assets

	2010 Rs. 000	2009 Rs. 000
<b>Interest Income from Foreign Currency Financial Assets</b>		
Cash & Cash Equivalents	1,827,313	1,397,611
Financial Assets	9,001,207	3,181,686
IMF Related Assets	13,360	16,559
<b>Total Interest Income from Foreign Currency Financial Assets</b>	<b>10,841,880</b>	<b>4,595,856</b>
<b>Interest Income from Local Currency Financial Assets</b>		
Investment Portfolio – Sri Lanka Government		
Securities	5,517,540	27,706,386
Other Loans and Advances	386,897	404,951
<b>Total Net Interest Income from Local Currency Financial Assets</b>	<b>5,904,437</b>	<b>28,111,337</b>
<b>Total Interest Income from Financial Assets</b>	<b>16,746,317</b>	<b>32,707,193</b>

**25. Interest Expense On Financial Liabilities**

	2010 Rs. 000	2009 Rs. 000
<b>Interest Expense on Foreign Currency Financial Liabilities</b>		
Amount Payable to Asian Clearing Union	49,318	24,560
IMF Related Liabilities	1,700,366	826,617
SWAP Cost	1,971,544	903,652
Other Foreign Payable	159,931	77,607
<b>Total Interest Expense on Foreign Currency Financial Liabilities</b>	<b>3,881,159</b>	<b>1,832,436</b>

**Interest Expense on Local Currency Financial Liabilities**

Securities Sold Under Agreements to Repurchase - TBills	2,069,217	1,053,305
- T Bonds	1,369,727	-
Fees Paid on Bond Borrowing	58,735	-
CBSL Securities	6,625,983	1,481,515
<b>Total Interest Expense on Local Currency Financial Liabilities</b>	<b>10,123,663</b>	<b>2,534,820</b>
<b>Total Interest Expense on Financial Liabilities</b>	<b>14,004,822</b>	<b>4,367,256</b>

SWAP Cost – Bank has entered into a SWAP facility with a foreign central bank from February 2009 for USD 200 Mn. A total of Rs 794.486 Mn (2009 -Rs.754.824 Mn) included in the SWAP cost.

**26. Other Income**

	2010 Rs. 000	2009 Rs. 000
Dividend Income - Related Party	-	25,163
- Others	7,582	863
Gain on Disposal of Property, Plant & Equipment	3,402	(741)
Gain on Disposal of Investments in Financial and Other Institutions	39,304	103,143
Amortization of Deferred Grant	462	72
Miscellaneous Income	774,931	415,717
<b>Total Other Income</b>	<b>825,681</b>	<b>544,217</b>

**27. Personnel Expenses**

	2010 Rs. 000	2009 Rs. 000
Wages and Salaries including PAYE Tax paid by the Employer	2,224,931	2,128,264
Defined Contribution Plan Costs	305,487	276,101
Post Employee Defined Benefit Plan Costs	(262,190)	-
<b>Total Personnel Expenses</b>	<b>2,268,228</b>	<b>2,404,365</b>

**28. Administration Expenses**

	2010 Rs. 000	2009 Rs. 000
Repairs and Maintenance	480,926	472,315
Information	90,284	61,687
Operational Travel	63,071	39,210
Rental Expenses	919	717
Printing	23,703	28,492
Audit Fees - Current Year	10,077	7,700
- Previous Year under Provision	4,206	-
Remuneration to Members of the Monetary Board	501	509
Miscellaneous	481,495	302,677
<b>Total Other Operating Expenses</b>	<b>1,155,182</b>	<b>913,307</b>

**29. Income Tax**

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

During the period an amount of Rs. 795.779 Mn (2009 – Rs. 1,516.373 Mn) was expensed in relation to such withholding tax, payable on interest income of Rs. 7,478.116 Mn (2009 – Rs. 19,013.069 Mn) & dividend income of Rs.7.582 Mn (2009 – Rs.26.026 Mn). In addition, the bank paid Economic Service Charge amounting to Rs. 95.489 Mn, in 2010 (2009 – Rs. 120 Mn).

<b>30. Reconciliation Of Operating Profit With Operating Cash Flow</b>			<b>31. Issues/(Withdrawals) Of Circulation Currency On Government Transactions</b>		
	2010 Rs. 000	2009 Rs. 000		2010 Rs. 000	2009 Rs. 000
<b>Reported Net Profit from Operating Activities</b>	11,743,953	33,638,649	Purchases of Government of Sri Lanka Securities for Investment Portfolio	(21,279,060)	(114,576,051)
<b>Add / (Less) Non-Cash Items</b>			Interest Received – Local Currency – Investment Portfolio	(7,191,222)	(29,451,452)
Depreciation	278,453	295,759	Increase /(Decrease) in Advances to GOSL	3,998,323	(2,427,200)
Interest Received – Local Currency – Investment Portfolio	(5,517,540)	(27,706,386)	(Increase) /Decrease in Balances with Government and Government Entities	(738,598)	(1,102,085)
Bad Debt Written Back	(167,545)	(44,945)		<u>(25,210,557)</u>	<u>(147,556,788)</u>
Bad Debt & Other Sundry Written Off	1,108,000	-			
Gross Unrealised Foreign Exchange (Gain) /Loss	6,508,504	(8,168,560)			
Other Provision	323,525	23,042,373			
Deferred Grants	(462)	(72)			
Provision for slow moving inventory written back	-	(30,300)			
<b>Add/ (Less) Movements in Other Working Capital Items</b>			<b>32. Net Issues/(Withdrawals) Or Circulation Currency On Bank And Financial Institutions Transactions</b>		
(Increase) /Decrease in Inventories	(657,585)	(165,213)		2010 Rs. 000	2009 Rs. 000
(Increase) /Decrease in Interest Receivable	(2,394,579)	(927,698)	(Increase) /Decrease in Deposits by Banks and Financial Institutions	(18,866,241)	(4,149,819)
Increase /(Decrease) in Miscellaneous Liabilities	14,120	(686,675)		<u>(18,866,241)</u>	<u>(4,149,819)</u>
Increase /(Decrease) in Interest Payable	(172,344)	247,220			
Increase /(Decrease) in Other Receivable	(2,402,277)	67,373	<b>33. Closing Cash And Cash Equivalents</b>		
<b>Add (Subtract) Investing and Financing Activities</b>				2010 Rs. 000	2009 Rs. 000
Income from investment	11,695	-	<b>Foreign Currency Assets</b>		
Net Unrealised Market Value Changes	3,484,968	4,177,107	Cash Balances with Other Foreign Banks	189,664,726	147,871,157
<b>Net Cash Flow From Operating Activities</b>	<u>12,160,887</u>	<u>23,738,632</u>	<b>Closing Cash &amp; Cash Equivalents</b>	<u>189,664,726</u>	<u>147,871,157</u>

### 34. Concentrations Of Funding

The bank's significant end-of-year concentrations of funding were as follows.

	2010 Total	Sri Lanka Government	Sri Lanka Public	Sri Lanka Commercial Banks	Supranational Financial Institutions	Other
As at 31 December, 2010	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000
<b>Foreign Currency Financial Liabilities</b>						
Amount Payable to Banks and Financial Institutions	3,127,136	-	-	-	387,905	2,739,231
Amount Payable to Asian Clearing Union	65,044,407	-	-	-	65,044,407	-
IMF Related Liabilities	275,420,837	-	-	-	275,420,837	-
Other Foreign Payables	5,014,191	-	-	1,883,191	3,131,000	-
<b>Total Foreign Currency Financial Liabilities</b>	<b>348,606,571</b>	<b>-</b>	<b>-</b>	<b>1,883,191</b>	<b>343,984,149</b>	<b>2,739,231</b>
<b>Local Currency Financial Liabilities</b>						
Deposits by Banks and Financial Institutions	104,853,445	-	-	104,853,445	-	-
Balances with Government and Government Entities	3,088,658	2,252,713	835,946	-	-	-
Domestic Securities Issued by CBSL	95,054,891	-	-	95,054,891	-	-
Securities Sold Under Agreements to Repurchase	18,400,000	-	-	18,400,000	-	-
Balances with Employee Benefits Plan	977,154	-	-	-	-	977,154
Other Payables	27,779,723	8,148	1,175,758	182,000	-	26,413,816
<b>Total Local Currency Financial Liabilities</b>	<b>250,153,871</b>	<b>2,260,861</b>	<b>2,011,704</b>	<b>313,618,651</b>	<b>-</b>	<b>27,390,970</b>
<b>Total Financial Liabilities</b>	<b>598,760,442</b>	<b>2,260,861</b>	<b>2,011,704</b>	<b>315,501,842</b>	<b>343,984,149</b>	<b>30,130,202</b>
<b>Other Liabilities</b>						
Currency in Circulation	255,652,218	-	255,652,218	-	-	-
Deferred Grants	4,605	-	-	-	-	4,605
Pension and Other Post Employment Benefit Plans	-	-	-	-	-	-
Miscellaneous Liabilities and Accruals	74,381	8,943	-	-	-	65,439
<b>Total Other Liabilities</b>	<b>255,731,204</b>	<b>8,943</b>	<b>255,652,218</b>	<b>-</b>	<b>-</b>	<b>70,044</b>
<b>Total Liabilities</b>	<b>854,491,646</b>	<b>2,269,803</b>	<b>257,663,922</b>	<b>315,501,842</b>	<b>343,984,149</b>	<b>30,200,245</b>

Comparative Figures As at 31 December 2009 are as Follows;

As at 31 December 2009	2009 Total Rs. 000	Sri Lanka Government Rs. 000	Sri Lanka Public Rs. 000	Sri Lanka Commercial Banks Rs. 000	Supranational Financial Institutions Rs. 000	Others Rs. 000
<b>Foreign Currency Financial Liabilities</b>						
Amount Payable to Banks and Financial Institutions	18,068,841	-	-	-	202,565	17,866,276
Amount Payable to Asian Clearing Union	29,836,531	-	-	-	29,836,531	-
IMF Related Liabilities	218,171,021	-	-	-	218,171,021	-
Other Foreign Payables	5,008,036	-	-	1,842,775	3,165,261	-
<b>Total Foreign Currency Financial Liabilities</b>	<b>271,084,429</b>	<b>-</b>	<b>-</b>	<b>1,842,775</b>	<b>251,375,378</b>	<b>17,866,276</b>
<b>Local Currency Financial Liabilities</b>						
Deposits by Banks and Financial Institutions	86,085,866	-	-	86,082,390	-	3,476
Balances with Government and Government Entities	2,347,709	2,347,107	601	-	-	-
Domestic Securities Issued by CBSL	78,022,645	-	-	78,022,645	-	-
Securities Sold Under Agreements to Repurchase	6,000,000	-	-	6,000,000	-	-
Balances with Employee Benefits Plan	1,050,255	-	-	-	-	1,050,255
Other Payables	25,981,654	68,967	-	182,000	-	25,730,687
<b>Total Local Currency Financial Liabilities</b>	<b>199,488,128</b>	<b>2,416,074</b>	<b>601</b>	<b>170,287,035</b>	<b>-</b>	<b>26,784,418</b>
<b>Total Financial Liabilities</b>	<b>470,572,557</b>	<b>2,416,074</b>	<b>601</b>	<b>172,129,810</b>	<b>251,375,378</b>	<b>44,650,694</b>
<b>Other Liabilities</b>						
Currency in Circulation	217,429,835	-	217,429,835	-	-	-
Deferred Grants	567	-	-	-	-	567
Pension and Other Post Employment Benefit Plans	-	-	-	-	-	-
Miscellaneous Liabilities and Accruals	66,895	17,552	-	-	-	49,343
<b>Total Other Liabilities</b>	<b>217,497,297</b>	<b>17,552</b>	<b>217,429,835</b>	<b>-</b>	<b>-</b>	<b>49,910</b>
<b>Total Liabilities</b>	<b>688,069,854</b>	<b>2,433,626</b>	<b>217,430,436</b>	<b>172,129,810</b>	<b>251,375,378</b>	<b>44,700,604</b>

### 35. RISK MANAGEMENT

The Central Bank together with the Monetary Board has two statutory objectives, i.e., economic and price stability and financial system stability and it has wide statutory powers to implement economic and financial policies to secure its objectives. Therefore, the effectiveness of the risk management of performance of the bank cannot be measured by the amount of its profit as the bank has policy-making powers to acquire financial assets by printing money and to influence interest rates, exchange rate and credit. Therefore, the profit or loss is only a neutral financial outcome of the activities of the bank and its operations and policies are not geared at profit.

However, in the course of carrying out its functions, the bank is faced with risks such as reputational risks, financial risks and operational risks. The bank's management seeks to ensure that strong and effective risk management and control systems are in place for assessing, monitoring and managing risk exposure.

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

The high level Risk Management Committee, chaired by



the Governor comprises all Deputy Governors, Assistant Governors and Heads of key departments involved in the risk management function. The Committee has the overall responsibility for the development of the risk strategy and implementing principles, frameworks, policies and limits. It is responsible to ensure that mechanisms are in place to identify potential risks and to take appropriate actions to mitigate such risks. The Committee also seeks to ensure that all necessary internal controls are in place and the risks related to the automated systems used by the bank, such as the Real-Time Gross Settlement System (RTGS), the Scriptless Securities Settlement System (SSSS), the General Ledger System and the Treasury Dealing Room Management System (TDRMS) are controlled.

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

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

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

A Counter party Credit Risk Management System is used by the IOD to manage the credit risk of the foreign assets portfolio based on the credit ratings of the investments and the counter parties. Interest rate risk or the exposure of the bank's foreign assets portfolio to movements in the interest rate is managed through the appropriate adjustments of the duration of the portfolio. The foreign exchange risk or the capital loss as a consequence of fluctuations in the exchange rates is managed mainly through diversification of investment currencies. In the management of foreign reserves, minimizing liquidity risk is the prime consideration in order to maintain an effective foreign exchange intervention capability. Policies for managing the credit, interest rate, foreign exchange and liquidity risks are outlined in sections 35.1, 35.2, 35.3 & 35.4, respectively.

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

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

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

**35.1 Credit Risk**

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

**Concentrations of credit Exposure by geographical area**

	2010 Rs. 000	2009 Rs. 000
Sri Lanka	105,425,234	120,604,925
USA	199,079,811	170,269,297
Japan	36,511,236	15,189,710
Britain	116,077,064	70,101,508
Europe	129,946,840	102,520,720
Supranational	138,080,144	170,433,627
Other	180,369,145	69,913,170
<b>Total Financial Assets</b>	<b>905,489,474</b>	<b>719,032,957</b>

**(b) Concentrations of Credit Exposure**

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

	2010 Rs. 000	2009 Rs. 000
Government	523,876,520	422,398,857
Supranational Financial Institutions	138,080,144	170,433,627
Foreign Banks and Financial Institutions	238,824,368	124,737,773
Other	4,708,442	1,462,700
<b>Total Financial Assets</b>	<b>905,489,474</b>	<b>719,032,957</b>

**Credit Exposure by Credit Rating**

	Credit Rating	2010		2009	
		Rs. 000	%	Rs. 000	%
<b>Cash &amp; Cash Equivalents</b>					
Federal Reserve Bank - USA/Reserve Bank of Australia/ Bank for International Settlements/ Bank of Japan					
		54,443,540	6%	80,272,413	11%
	AAA	28,293,015	3%	44,286,854	6%
	AA+	8,558,590	1%	-	0%
	AA	39,473,242	4%	8,075,290	1%
	AA-	51,998,269	6%	11,210,371	2%
	A-1+	5,870,267	1%	520,105	0%
	A-1	617,323	0%	-	0%
	NR	410,480	0%	3,506,124	0%
		<b>189,664,726</b>	<b>21%</b>	<b>147,871,157</b>	<b>21%</b>

**(c) Credit Exposure by Credit Rating**

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

<b>Foreign Currency Trading/ Available for Sale Securities</b>					
	<b>Credit Rating</b>	<b>2010</b>		<b>2009</b>	
		<b>Rs. 000</b>	<b>%</b>	<b>Rs. 000</b>	<b>%</b>
Federal Reserve Bank - USA/Reserve Bank of Australia/ Bank for International Settlements/ Bank of Japan		-	0%	8,477,892	1%
	AAA	332,931,959	37%	95,928,452	13%
	AA+	2,759,132	0%	12,237,966	2%
	AA	6,211,982	1%	7,182,081	1%
	AA-	10,075,211	1%	-	0%
	A+	3,106,073	0%	2,288,878	0%
	A	-	0%	1,806,969	0%
	A-	8,243,605	1%	3,846,837	1%
	B-	-	0%	1,676,346	0%
	NR	167,337,454	18%	238,172,353	33%
		<u>530,665,416</u>	<u>59%</u>	<u>371,617,774</u>	<u>52%</u>
IMF Related Assets	AAA	71,199,269	8%	76,509,781	11%
<b>Other Foreign Receivables</b>					
Federal Reserve Bank - USA/Reserve Bank of Australia/ Bank for International Settlements/ Bank of Japan		8,450	0%	11,278	0%
	AAA	3,038,586	0%	515,010	0%
	AA+	257	0%	-	0%
	AA	8,835	0%	1,254	0%
	AA-	3,938	0%	5,725	0%
	NR	5,474,762	1%	1,896,053	0%
		<u>8,534,828</u>	<u>1%</u>	<u>2,429,320</u>	<u>0%</u>
<b>Total Foreign Currency Financial Assets</b>		<u>800,064,240</u>		<u>598,428,032</u>	
<b>Local Currency Financial Assets</b>					
Sri Lanka Government Securities	B+	20,497,816	2%	43,450,557	7%
Loans to Government	B+	77,878,823	9%	73,880,500	10%
Loans to Other Institutions	NR	2,459,846	0%	1,136,596	0%
Other Local Receivable	B+	464,971	0%	250,000	0%
	NR	2,809,921	0%	345,444	0%
Investments in Financial and Other Institutions	NR	41,236	0%	43,855	0%
Other Assets	B+	1,272,621	0%	1,497,973	0%
<b>Total Local Currency Financial Assets</b>		<u>105,425,234</u>	<u>12%</u>	<u>120,604,925</u>	<u>17%</u>
<b>Total Financial Assets</b>		<u>905,489,474</u>	<u>100%</u>	<u>719,032,957</u>	<u>100%</u>
<b>(d) Summary by Major Credit Category</b>					
<b>Foreign Currency Financial Assets</b>					
Federal Reserve Bank - USA/Reserve Bank of Australia/ Bank for International Settlements/ Bank of Japan		54,451,990	6%	88,731,583	12%
IMF Related Assets		71,199,269	8%	76,509,781	11%
	AAA	364,263,560	40%	140,730,317	20%
	AA+/-	119,089,455	13%	38,712,686	5%
	A+/-	11,349,678	1%	8,462,789	1%
	A-1 +/-	6,487,590	1%	-	0%
	B-	-	0%	1,676,346	0%
	NR	173,222,698	19%	243,604,530	34%
<b>Total Foreign Currency Financial Assets</b>		<u>800,064,240</u>	<u>88%</u>	<u>598,428,032</u>	<u>83%</u>
<b>Local Currency Financial Assets</b>					
	B +/-	100,114,231	11%	119,079,030	17%
	NR	5,311,003	1%	1,525,895	0%
<b>Total Local Currency Financial Assets</b>		<u>105,425,234</u>	<u>12%</u>	<u>120,604,925</u>	<u>17%</u>
<b>Total Financial Assets</b>		<u>905,489,474</u>	<u>100%</u>	<u>719,032,957</u>	<u>100%</u>

### 35.2 Interest Rate Risk

#### (a) Foreign Currency Interest rate sensitivity

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

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

Portfolio Segment	Potential Loss ( USD Mn)	
	2010	2009
Money Market	10.41	2.59
Available for Sale	13.59	6.24
<b>Total</b>	<b>24.00</b>	<b>8.83</b>

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

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

#### Modified Duration

Investment Segment	Modified Duration	
	As at 31/12/2010	As at 31/12/2009
Money Market (Fixed and call deposits)	0.01	0.03
Capital Market (Fixed Income Securities)	4.96	2.87
Overall	3.72	1.84

- ii) Since the modified duration does not account for large changes in prices another measure of interest rate risk of the foreign reserves portfolio used for risk management 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 of the segmented Fixed Income Securities portfolio

Portfolio Segment	Potential Loss (US\$ Mn)	
	2010	2009
Trading	0.51	0.5
Available for Sale	0.31	0.11
<b>Total</b>	<b>0.38</b>	<b>0.17</b>

#### (b) Local Currency Interest Rate Sensitivity

The local Treasury bills portfolio is recorded in the Statement of Financial Position of the CBSL at amortized cost as it represents loans provided to the Government of Sri Lanka. This portfolio is not an investment portfolio, as the bank does not purchase Treasury bills with the intention of earning an interest income. The bank purchases or sells Treasury bills to inject rupee liquidity into the domestic market or to absorb liquidity from the market in the course of carrying out its monetary policy operations in relation to one of its core objectives, namely maintaining economic and price

stability. Hence, the volume of Treasury bills in the bank's portfolio is determined by its monetary policy operations. In addition, the basic interest rates in the rupee market, namely, the Repo rate and the Reverse Repo rate are policy rates determined by the bank in the course of implementing its monetary policy. Moreover, the 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 Ave. Int. Rate %	2010 Total Rs. 000	6 Months or Less Rs. 000	6 to 12 Months Rs. 000	1 to 2 Years Rs. 000	2 to 5 Years Rs. 000	Over 5 Years Rs. 000
<b>Interest sensitive Foreign currency financial assets</b>							
Cash & Cash equivalents	0.25	189,664,726	189,664,726	-	-	-	-
Securities at Fair Value through Profit and Loss and Available for Sale Investments	2.86	530,665,416	21,235,923	39,281,454	56,457,478	127,798,550	285,892,011
IMF related assets	0.32	273,070	273,070	-	-	-	-
<b>Total Interest sensitive Foreign Currency Financial Assets</b>		<u>720,603,212</u>	<u>211,173,720</u>	<u>39,281,454</u>	<u>56,457,478</u>	<u>127,798,550</u>	<u>285,892,011</u>
<b>Non interest sensitive foreign currency financial assets</b>							
IMF Related assets		70,926,199	-	-	-	-	70,926,199
Receivables		8,534,829	8,534,829	-	-	-	-
<b>Total Non Interest sensitive Foreign Currency Financial Assets</b>		<u>79,461,028</u>	<u>8,534,829</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>70,926,199</u>
<b>Total Foreign Currency Financial Assets</b>		<u>800,064,240</u>	<u>219,708,548</u>	<u>39,281,454</u>	<u>56,457,478</u>	<u>127,798,550</u>	<u>356,818,210</u>
<b>Interest sensitive Foreign currency financial liabilities</b>							
IMF related liabilities	0.02	145,410,048	655,843	655,843	6,314,221	137,784,141	-
Amounts payable to Asian Clearing Union	0.21	65,044,407	65,044,407	-	-	-	-
<b>Total Interest sensitive Foreign currency financial liabilities</b>		<u>210,454,455</u>	<u>65,700,250</u>	<u>655,843</u>	<u>6,314,221</u>	<u>137,784,141</u>	<u>-</u>
<b>Non interest sensitive Foreign currency financial liabilities</b>							
IMF related liabilities		130,384,184	373,395	-	-	-	130,010,789
Commercial bank capital in foreign currency		1,883,191	-	-	-	-	1,883,191
Other foreign liabilities		5,884,741	5,884,741	-	-	-	-
<b>Total Non interest sensitive Foreign currency financial liabilities</b>		<u>138,152,116</u>	<u>6,258,136</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>131,893,980</u>
<b>Total foreign currency financial liabilities</b>		<u>348,606,571</u>	<u>71,958,386</u>	<u>655,843</u>	<u>6,314,221</u>	<u>137,784,141</u>	<u>131,893,980</u>
<b>Foreign currency Interest rate sensitivity Gap</b>		<u>510,148,758</u>	<u>145,473,470</u>	<u>38,625,610</u>	<u>50,143,257</u>	<u>(9,985,590)</u>	<u>285,892,011</u>

	Weighted Avg. Int. Rate %	2010 Total Rs. 000	6 Months or Less Rs. 000	6 to 12 Months Rs. 000	1 to 2 Years Rs. 000	2 to 5 Years Rs. 000	Over 5 Years Rs. 000
<b>Interest sensitive Local currency Financial Assets</b>							
Investment portfolio-Sri Lanka Government Securities	7.28	20,497,816	7,113,152	13,384,664	-	-	-
Loans to Other Institutions	6.49	2,459,846	280,955	168,590	255,725	1,754,576	-
Other assets	7.59	1,272,621	340,938	716,936	83,666	131,081	-
<b>Total Interest sensitive Local Currency Financial Assets</b>		<u>24,230,283</u>	<u>7,735,044</u>	<u>14,270,189</u>	<u>339,392</u>	<u>1,885,657</u>	<u>-</u>
<b>Non Interest sensitive local currency assets</b>							
Loans to Government		77,878,823	77,878,823	-	-	-	-
Receivables		4,374,892	3,909,921	-	-	-	464,971
Investment in Equity Securities - Available for Sale		41,236	-	-	-	-	41,236
<b>Total non Interest sensitive local Currency Assets</b>		<u>82,294,952</u>	<u>81,788,744</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>506,207</u>
<b>Total local currency assets</b>		<u>106,525,234</u>	<u>89,523,788</u>	<u>14,270,189</u>	<u>339,392</u>	<u>1,885,657</u>	<u>506,207</u>
<b>Interest sensitive Local currency financial liabilities</b>							
Securities sold under agreement to repurchase	7.25	18,400,000	18,400,000	-	-	-	-
Domestic Securities Issued by CBSL	7.25	95,054,891	95,054,891	-	-	-	-
<b>Total Interest sensitive Local Currency Financial liabilities</b>		<u>113,454,891</u>	<u>113,454,891</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
<b>Non interest sensitive Local currency liabilities</b>							
Balances with Banks and Financial Institutions		104,853,445	104,853,445	-	-	-	-
Balances with Government and Government Entities		3,088,658	3,088,658	-	-	-	-
Balances with Employee Benefit Plans		977,154	107,454	-	869,700	-	-
Other Payables		27,779,723	27,779,723	-	-	-	-
<b>Total Non interest sensitive Local currency financial liabilities</b>		<u>136,698,980</u>	<u>135,829,280</u>	<u>-</u>	<u>869,700</u>	<u>-</u>	<u>-</u>
<b>Total Local currency financial liabilities</b>		<u>250,153,871</u>	<u>249,284,171</u>	<u>-</u>	<u>869,700</u>	<u>-</u>	<u>-</u>
<b>Local currency Interest rate sensitivity Gap</b>		<u>(89,224,608)</u>	<u>(105,719,846)</u>	<u>14,270,189</u>	<u>339,392</u>	<u>1,885,657</u>	<u>-</u>
Comparative figures as at 31 December 2009 were as follows							
<b>Foreign Currency Interest Rate Sensitivity Gap:</b>	<b>Weighted Ave. Int. Rate %</b>	<b>2009 Total Rs. 000</b>	<b>6 Months or Less Rs. 000</b>	<b>6 to 12 Months Rs. 000</b>	<b>1 to 2 Years Rs. 000</b>	<b>2 to 5 Years Rs. 000</b>	<b>Over 5 Years Rs. 000</b>
<b>Interest sensitive Foreign currency financial assets</b>							
Cash & Cash equivalents	1.07	147,871,157	147,871,157	-	-	-	-
Securities at Fair Value through Profit and Loss and Available for Sale Investments	2.24	371,617,775	28,448,309	19,141,034	111,328,788	149,534,851	63,182,854
IMF related assets	0.24	10,836,493	10,836,493	-	-	-	-
<b>Total Interest sensitive Foreign Currency Financial Assets</b>		<u>530,325,425</u>	<u>187,155,959</u>	<u>19,141,034</u>	<u>111,328,788</u>	<u>149,534,851</u>	<u>63,182,854</u>
<b>Non interest sensitive foreign currency financial assets</b>							
IMF Related assets		65,673,289	-	-	-	-	65,673,289
Receivables		2,429,319	2,429,319	-	-	-	-
<b>Total non Interest sensitive Foreign Currency Financial Assets</b>		<u>68,102,608</u>	<u>2,429,319</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>65,673,289</u>
<b>Total Foreign Currency Financial Assets</b>		<u>598,428,033</u>	<u>189,585,278</u>	<u>19,141,034</u>	<u>111,328,788</u>	<u>149,534,851</u>	<u>128,856,143</u>

<b>Interest sensitive Foreign currency financial liabilities</b>							
IMF related liabilities	0.08	82,201,426	3,301,811	685,903	1,371,805	76,841,907	-
Amounts payable to Asian Clearing Union	0.14	29,836,531	29,836,531	-	-	-	-
<b>Total Interest sensitive Foreign currency financial liabilities</b>		<u>112,037,957</u>	<u>33,138,342</u>	<u>685,903</u>	<u>1,371,805</u>	<u>76,841,907</u>	<u>-</u>
<b>Non interest sensitive Foreign currency financial liabilities</b>							
IMF related liabilities		136,168,229	198,634	-	-	-	135,969,595
Commercial bank capital in foreign currency		1,842,775	-	-	-	-	1,842,775
Other foreign liabilities		21,035,468	21,035,468	-	-	-	-
<b>Total Non interest sensitive Foreign currency financial liabilities</b>		<u>159,046,472</u>	<u>21,234,102</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>137,812,370</u>
<b>Total foreign currency financial liabilities</b>		<u>271,084,429</u>	<u>54,372,444</u>	<u>685,903</u>	<u>1,371,805</u>	<u>76,841,907</u>	<u>137,812,370</u>
<b>Foreign currency Interest rate sensitivity Gap</b>		<u>418,287,468</u>	<u>154,017,617</u>	<u>18,455,131</u>	<u>109,956,983</u>	<u>72,692,944</u>	<u>63,182,854</u>
	<b>Weighted</b>	<b>2009</b>	<b>6 Months</b>	<b>6 to 12</b>	<b>1 to 2</b>	<b>2 to 5</b>	<b>Over 5</b>
	<b>Avg. Int.</b>	<b>Total</b>	<b>or Less</b>	<b>Months</b>	<b>Years</b>	<b>Years</b>	<b>Years</b>
<b>Interest sensitive local currency financial assets</b>	<b>Rate %</b>	<b>Rs. 000</b>	<b>Rs. 000</b>	<b>Rs. 000</b>	<b>Rs. 000</b>	<b>Rs. 000</b>	<b>Rs. 000</b>
Investment portfolio-Sri Lanka Government Securities	11.24	43,450,557	32,626,178	10,824,379	-	-	-
Loans to Other Institutions	3	1,136,596	197,541	194,393	292,541	452,121	-
Other assets	14.56	1,490,476	318,153	904,015	258,866	9,442	-
<b>Total Interest sensitive local Currency Financial Assets</b>		<u>46,077,629</u>	<u>33,141,872</u>	<u>11,922,787</u>	<u>551,407</u>	<u>461,563</u>	<u>-</u>
<b>Non Interest sensitive local currency assets</b>							
Loans to Government		73,880,500	73,880,500	-	-	-	-
Receivables		595,444	345,444	-	-	-	250,000
Investment in Equity Securities - Available for Sale		43,855	732	-	-	-	43,123
Other Assets		7,497	7,497	-	-	-	-
<b>Total non Interest sensitive local Currency Assets</b>		<u>74,527,296</u>	<u>74,234,173</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>293,123</u>
<b>Total local currency assets</b>		<u>120,604,925</u>	<u>107,376,045</u>	<u>11,922,787</u>	<u>551,407</u>	<u>461,563</u>	<u>293,123</u>
<b>Interest sensitive Local currency financial liabilities</b>							
Securities sold under agreement to repurchase	8.65	6,000,000	6,000,000	-	-	-	-
Domestic Securities Issued by CBSL	8.59	78,022,645	78,022,645	-	-	-	-
<b>Total Interest sensitive Local currency financial liabilities</b>		<u>84,022,645</u>	<u>84,022,645</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
<b>Non interest sensitive Local currency liabilities</b>							
Balances with Banks and Financial Institutions		86,085,866	86,085,866	-	-	-	-
Balances with Government and Government Entities		2,347,709	2,347,709	-	-	-	-
Balances with Employee Benefit Plans		1,050,255	1,050,255	-	-	-	-
Other Deposits & payables		25,981,654	25,981,654	-	-	-	-
Other Liabilities		-	-	-	-	-	-
<b>Total Non interest sensitive Local currency financial liabilities</b>		<u>115,465,484</u>	<u>115,465,484</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
<b>Total Local currency financial liabilities</b>		<u>199,488,129</u>	<u>199,488,129</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
<b>Local currency Interest rate sensitivity Gap</b>		<u>(37,945,016)</u>	<u>(50,880,773)</u>	<u>11,922,787</u>	<u>551,407</u>	<u>461,563</u>	<u>293,123</u>

### 35.3 Foreign Currency Risk

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

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

#### Net Exposure to foreign currencies

As at 31 December, 2010, the Central Bank of Sri Lanka's net exposure to major currencies was as follows.

	Currency							Total All Currencies
	United States Dollars	Euro	Japanese Yen	Sterling Pound	SDR	AUD	Other Currencies	
As at 31 December 2010	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000
<b>Foreign Currency Financial Assets</b>								
Cash & Cash Equivalents	110,943,443	18,181,304	27,168,738	31,237,633	-	1,283,105	850,504	189,664,726
Securities at Fair Value through Profit or Loss and Available for Sale Investments	227,595,072	84,105,234	8,223,203	116,674,396	-	92,352,204	1,715,307	530,665,416
IMF Related Assets	-	-	-	-	71,199,269	-	-	71,199,269
Other Foreign Receivables	14,962	6,831,798	1,643,522	952	2,119	41,474	-	8,534,828
<b>Total Foreign Currency Financial Assets</b>	<u>338,553,477</u>	<u>109,118,335</u>	<u>37,035,463</u>	<u>147,912,981</u>	<u>71,201,388</u>	<u>93,676,783</u>	<u>2,565,811</u>	<u>800,064,240</u>
Proportion	42%	14%	5%	18%	9%	12%	0%	100%
<b>Foreign Currency Financial Liabilities</b>								
Amount Payable to Banks and Financial Institutions	153,115	1,504,401	1,094,297	340	373,395	1,588	-	3,127,136
Amount Payable to Asian Clearing Union	66,151,121	(1,106,714)	-	-	-	-	-	65,044,407
IMF Related Liabilities	-	-	-	-	275,420,837	-	-	275,420,837
Other foreign payables	5,014,191	-	-	-	-	-	-	5,014,191
<b>Total Foreign Currency Financial Liabilities</b>	<u>71,318,427</u>	<u>397,687</u>	<u>1,094,297</u>	<u>340</u>	<u>275,794,232</u>	<u>1,588</u>	<u>-</u>	<u>348,606,570</u>
Proportion	20%	0%	0%	0%	79%	0%	0%	100%
<b>Net Foreign Currency Exposure</b>	<u>267,235,050</u>	<u>108,720,649</u>	<u>35,941,166</u>	<u>147,912,641</u>	<u>(204,592,843)</u>	<u>93,675,195</u>	<u>2,565,811</u>	<u>451,457,670</u>



### 35.3 Foreign Currency Risk (Continued)

As at 31 December 2009, the Central Bank of Sri Lanka's net exposure to major currencies was as follows.

	Currency							Total All Currencies Rs. 000
	United States Dollars Rs. 000	Euro Rs. 000	Japanese Yen Rs. 000	Sterling Pound Rs. 000	SDR Rs. 000	AUD Rs. 000	Other Currencies Rs. 000	
<b>As at 31 December 2009</b>								
<b>Foreign Currency Financial Assets</b>								
Cash & Cash Equivalents	38,674,007	40,395,988	10,595,236	18,494,893	-	47,649,480	(7,938,448)	147,871,157
Securities at Fair Value through Profit and Loss and Available for Sale Investments	195,445,909	44,145,531	9,203,770	73,788,798		49,033,768	-	371,617,776
IMF Related Assets	-	-	-	-	76,509,781	-	-	76,509,781
Other Foreign Receivables	169	4,607	-	1,898,236	1,840	500,536	23,932	2,429,320
<b>Total Foreign Currency Financial Assets</b>	<u>234,120,085</u>	<u>84,546,126</u>	<u>19,799,006</u>	<u>94,181,927</u>	<u>76,511,621</u>	<u>97,183,784</u>	<u>(7,914,516)</u>	<u>598,428,034</u>
Proportion	39%	14%	3%	16%	13%	16%	-1%	100%
<b>Foreign Currency Financial Liabilities</b>								
Amount Payable to Banks and Financial Institutions	3,325,965	83	1,245,353	3,691,032	198,634	12,773,034	-	21,234,101
Amount Payable to Asian Clearing Union	29,705,557	130,975	-	-	-	-	-	29,836,532
IMF Related Liabilities	-	-	-	-	218,171,021	-	-	218,171,021
Commercial Banks – Capital Deposits in Foreign Currency	1,842,775	-	-	-	-	-	-	1,842,775
<b>Total Foreign Currency Financial Liabilities</b>	<u>34,874,297</u>	<u>131,058</u>	<u>1,245,353</u>	<u>3,691,032</u>	<u>218,369,655</u>	<u>12,773,034</u>	<u>-</u>	<u>271,084,429</u>
Proportion	13%	0%	0%	1%	81%	5%	0%	100%
<b>Net Foreign Currency Exposure</b>	<u>199,245,788</u>	<u>84,415,068</u>	<u>18,553,653</u>	<u>90,490,895</u>	<u>(141,858,034)</u>	<u>84,410,750</u>	<u>(7,914,516)</u>	<u>327,343,605</u>

### 35.4 Liquidity risk

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

(a) Liquidity is a key consideration in determining the composition of the bank's foreign currency assets. This reflects the potential requirement to liquidate foreign reserves for intervention purposes and to

settle other commitments such as public debt and IMF Loan repayments when the need arises. The bank has adopted the following measures aimed at ensuring quick access to funds:

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

**Fair values and carrying amount**

Fair values	Carrying Amount		Fair Value	
	2010 Rs '000	2009 Rs '000	2010 Rs '000	2009 Rs '000
Cash & Cash Equivalents	189,664,726	147,871,157	189,664,726	147,871,157
Foreign Currency Trading/ Available for Sale Securities	530,665,416	371,617,775	530,665,416	371,617,775
IMF Related Assets	71,199,269	76,509,781	71,199,269	76,509,781
Other Foreign Receivables	8,534,829	2,429,319	8,534,829	2,429,319
	<u>800,064,240</u>	<u>598,428,032</u>	<u>800,064,240</u>	<u>598,428,032</u>
Sri Lanka Government Securities	20,497,816	43,450,557	20,497,816	43,450,557
Loans to Government	77,878,823	73,880,500	77,878,823	73,880,500
Loans to Other Institutes	2,459,846	1,136,596	2,459,846	1,136,596
Other Local Receivables	3,274,892	595,444	3,274,892	595,444
Investment in Financial and Other Institutions	41,236	43,855	41,236	43,855
Other Assets	1,272,621	1,497,973	1,272,621	1,497,973
<b>Total Financial Assets</b>	<u>905,489,474</u>	<u>719,032,957</u>	<u>905,489,474</u>	<u>719,038,957</u>
<b>Investment in Gold</b>				
Investments in Gold	54,007,207	84,834,269	54,007,207	84,834,269
<b>Total Foreign Currency Non Financial Assets</b>	<u>54,007,207</u>	<u>84,834,269</u>	<u>54,007,207</u>	<u>84,834,269</u>
<b>Financial liabilities</b>				
Amounts payable to Banks & Financial Institution	3,127,136	18,068,841	3,127,136	18,068,841
IMF related liabilities	275,420,837	218,171,021	275,420,837	218,171,021
Amounts payable to ACU	65,044,407	29,836,531	65,044,407	29,836,531
Other foreign payables	5,014,191	5,008,035	5,014,191	5,008,035
	<u>348,606,571</u>	<u>271,084,428</u>	<u>348,606,571</u>	<u>271,084,428</u>
Commercial Banks & Other Financial Institutions	104,853,445	86,085,866	104,853,445	86,085,866
Balances with Government and Government Entities	3,088,659	2,347,709	3,088,659	2,347,709
Securities sold under agreement to repurchase	113,454,891	84,022,645	113,454,891	84,022,645
Balances with Employee Benefits Plan	977,154	1,060,438	977,154	1,060,438
Other Payables	27,779,723	25,981,654	27,779,723	25,981,654
<b>Total Financial Liabilities</b>	<u>598,760,443</u>	<u>470,582,740</u>	<u>598,760,443</u>	<u>470,582,740</u>

b) In order to reduce the level of liquidity risk arising out of the local currency activities, particularly open market operations, the bank uses highly liquid marketable instruments such as Treasury Bills & Treasury Bonds as collateral. It manages the daily

liquidity position of the banking system by way of infusing into or withdrawal from the system, using instruments such as repo / reverse repo, CBSL securities & USD /LKR Swaps.

### 36. Pension and other Post Employment Benefit Plans

The bank operates five defined benefit plans which cover all eligible employees. Under the Employees' Retirement Pension Scheme, employees who joined the bank prior to 1 January 1998 and complete 10 years of service become eligible. The Pension Scheme is a non-contributory pension scheme where the cost of benefits is wholly borne by the bank. The Widows' and Orphans' Pension Scheme for male employees and Widowers' and Orphans' Pension Scheme for female employees are open to employees of the bank who had joined prior to 1 January 1998. Employees eligible under these plans contribute 5% of the monthly basic salary, who were recruited before 01.08.1994 and 10% of the monthly basic salary who were recruited on or after 01.08.1994.

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

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

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

Funds of the Employee Retirement Pension Scheme, Widows' and Orphans' Pension Scheme, Widowers' and Orphans' Pension Scheme are managed separately and separate books are maintained. However Gratuity Scheme & Medical Benefit Scheme are not separated from the books of accounts of the Bank. Further investments and investment income are recorded separately for these funds in the Bank books and the income earned from the investments are transferred back to these funds and reinvested without being distributed.

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

The total fair value of plan assets of Rs.26,012.196 Mn (2009 - Rs.23,331.568 Mn) exceeds the total present value of all benefit obligations of Rs.23,795.334 Mn (2009 - Rs.22,484.718 Mn) at the end of the reporting period resulting in a surplus of Rs. 2,216.862 Mn (2009 - Rs.846.850 Mn)

#### 2010

Benefit Liability/(Asset)	Employee Retirement Pension Scheme	Widows' and Orphans' Pension Scheme	Widowers' and Orphans' Pension Scheme	Gratuity Scheme	Medical Benefit Scheme	Total
	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000
Present Value of Benefit Obligation	19,536,003	2,665,510	500,571	61,781	1,031,469	23,795,334
Fair Value of Plan Assets	(18,501,515)	(4,793,392)	(1,444,366)	(51,325)	(1,221,598)	(26,012,196)
Unrecognised net Actuarial Gains/(Losses)	(551,240)	1,222,558	601,330	8,569	65,945	1,347,162
<b>Benefit Liability/ (Asset) non-current</b>	<b>483,248</b>	<b>(905,324)</b>	<b>(342,465)</b>	<b>19,025</b>	<b>(124,184)</b>	<b>(869,700)</b>

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

Movement in the Benefit Liability /(Asset)	Employee Retirement		Widows' and Widowers' and Orphans'		Medical Benefit Scheme	Total
	Pension Scheme	Pension Scheme	Pension Scheme	Gratuity Scheme		
	Rs. 000	Rs. 000	Rs. 000	Rs. 000		
As at 1 January 2010	482,363	(512,892)	(154,316)	6,618	(115,250)	(293,477)
Benefit Expense	324,168	(372,329)	(179,327)	12,407	(8,934)	(224,015)
Contribution Paid	(323,283)	(20,103)	(8,822)	-	-	(352,208)
<b>As at 31 December 2010 - non-current</b>	<b>483,248</b>	<b>(905,324)</b>	<b>(342,465)</b>	<b>19,025</b>	<b>(124,184)</b>	<b>(869,700)</b>
<b>Benefit Expense</b>						
Interest Cost on Benefit Obligation	1,851,102	252,315	47,391	4,851	92,814	2,248,473
Expected Return on Plan Assets	(1,658,096)	(427,438)	(127,246)	(4,567)	(115,810)	(2,333,157)
Net Actuarial (Gain) /Loss recognized during the year	-	(197,206)	(99,472)	-	(2,738)	(299,416)
Transitional Adjustment	-	-	-	-	-	-
Net Current Service Cost	131,162	-	-	12,123	16,800	160,085
Past Service Cost	-	-	-	-	-	-
<b>Net Benefit Expense</b>	<b>324,168</b>	<b>(372,329)</b>	<b>(179,327)</b>	<b>12,407</b>	<b>(8,934)</b>	<b>(224,015)</b>
<b>Actual Return on Plan Assets</b>	<b>2,492,358</b>	<b>667,371</b>	<b>175,787</b>	<b>9,112</b>	<b>164,987</b>	<b>3,509,615</b>
<b>Changes in Fair Value of Plan Assets</b>						
Fair Value of Plan Assets at the beginning of the year	16,580,964	4,274,380	1,272,456	45,669	1,158,099	23,331,568
Actual Return on Plan Assets	2,492,358	667,371	175,787	9,112	164,987	3,509,615
Contribution Received	323,283	20,103	8,822	-	-	352,208
Benefits Paid	(895,090)	(168,462)	(12,699)	(3,456)	(101,488)	(1,181,195)
<b>Fair value of Plan Assets at the end of the year</b>	<b>18,501,515</b>	<b>4,793,392</b>	<b>1,444,366</b>	<b>51,325</b>	<b>1,221,598</b>	<b>26,012,196</b>
<b>2009</b>						
<b>Benefit Liability/ (Assets)</b>	<b>Employee Retirement</b>		<b>Widows' and Widowers' and Orphans'</b>		<b>Medical</b>	<b>Total</b>
	<b>Pension Scheme</b>	<b>Pension Scheme</b>	<b>Pension Scheme</b>	<b>Gratuity Scheme</b>	<b>Benefit Scheme</b>	
	<b>Rs. 000</b>	<b>Rs. 000</b>	<b>Rs. 000</b>	<b>Rs. 000</b>	<b>Rs. 000</b>	<b>Rs. 000</b>
Present Value of Benefit Obligation	18,511,015	2,523,147	473,914	48,507	928,135	22,484,718
Fair Value of Plan Assets	(16,580,964)	(4,274,381)	(1,272,455)	(45,669)	(1,158,099)	(23,331,568)
Unrecognised net Actuarial Gains /(Losses)	(1,447,688)	1,238,342	644,226	3,781	114,714	553,374
Unrecognised Transitional Liability	-	-	-	-	-	-
<b>Benefit Liability/ (Asset) non-current</b>	<b>482,363</b>	<b>(512,892)</b>	<b>(154,316)</b>	<b>6,618</b>	<b>(115,250)</b>	<b>(293,476)</b>
<b>Movement in the Benefit Liability</b>						
As at 1 January 2009	1,380,171	(207,397)	(55,998)	(4,051)	(86,028)	1,026,697
Benefit Expense	316,319	39,368	23,848	10,669	(29,222)	360,983
Contribution Paid	(1,214,127)	(344,863)	(122,165)	-	-	(1,681,156)
<b>As at 31 December 2009 - non-current</b>	<b>482,363</b>	<b>(512,892)</b>	<b>(154,316)</b>	<b>6,618</b>	<b>(115,250)</b>	<b>(293,476)</b>

<b>Benefit Expense</b>						
Interest Cost on Benefit Obligation	1,584,768	364,307	111,064	4,319	86,616	2,151,074
Expected Return on Plan Assets	(1,392,879)	(340,724)	(98,679)	(5,055)	(110,615)	(1,947,952)
Net Actuarial (Gain) /Loss recognized during the year	-	15,785	11,463	-	(8,418)	18,830
Transitional Adjustment	-	-	-	-	-	-
Net Current Service Cost	124,430	-	-	11,405	3,195	139,030
Past Service Cost	-	-	-	-	-	-
<b>Net Benefit Expense</b>	<u>316,319</u>	<u>39,368</u>	<u>23,848</u>	<u>10,669</u>	<u>(29,222)</u>	<u>360,983</u>
<b>Actual Return on Plan Assets</b>	<u>2,339,910</u>	<u>674,626</u>	<u>174,043</u>	<u>4,655</u>	<u>133,656</u>	<u>3,326,889</u>
<b>Changes in Fair Value of Plan Assets</b>						
Fair Value of Plan Assets at the beginning of the year	13,928,786	3,407,239	986,792	50,552	1,106,147	19,479,516
Actual Return on Plan Assets	2,339,910	674,626	174,043	4,655	133,656	3,326,889
Contribution Received	1,214,127	344,863	122,165	-	-	1,681,156
Benefits Paid	(901,859)	(152,348)	(10,544)	(9,538)	(81,704)	(1,155,993)
<b>Fair value of Plan Assets at the end of the year</b>	<u>16,580,964</u>	<u>4,274,381</u>	<u>1,272,455</u>	<u>45,669</u>	<u>1,158,099</u>	<u>23,331,568</u>

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

	2010	2009
Discount Rate	10.00%	10.00%
Expected Rate of Return on Assets	10.00%	10.00%
Future Salary Increases	8.50%	8.50%
Future Pension Increases	7.50%	7.50%
Average Remaining years of Service		
CBSL Pension	2 Years	2 Years
W & OP Pension scheme	4 Years	5 Years
WR & OP Pension scheme	5 Years	6 Years
Gratuity scheme	14 Years	15 Years
CBSL Medical Benefit scheme	8 Years	8 Years
Retirement Age	60 years	60 years

### 37. Financial Instruments

#### Fair Value of Financial Instruments

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

#### Financial Assets and Liabilities

All financial assets and liabilities are valued at either quoted market prices or prices derived from market yield curves, as described in the bank's accounting policies, except as detailed below.

#### Repurchase and Reverse-Repurchase Agreements

The reported value of repurchase and reverse-repurchase agreements is considered to approximate their fair value due to the short term nature of the agreements. The carrying value of Sri Lanka Government Securities sold under agreements to repurchase as at 31 December 2010 was Rs. 18,400 Mn (2009 – Rs. 6,000 Mn) and CBSL Securities was Rs. 95,054.891 Mn (2009 - Rs. 78,022.645 Mn)

#### Currency in Circulation

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

#### Deposits

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

**38. Related Parties****38.1 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 are as follows:

Nature of transaction	2010 Rs 000	2009 Rs 000
Investment portfolio of Sri Lanka Government securities held by CBSL, as at 31 December (a)	20,497,816	43,450,557
Outright sales of government securities	3,450,000	26,804,878
CBSL and Government securities purchased / sold under agreement to repurchase / sales	6,175,811,262	1,751,900,559
Cost of printing currency notes, for the year ended 31 December (d)	692,036	972,801
Guarantees provided by CBSL, as at 31 December (Note 39)	1,795,450	1,148,253
Funds collected in respect of Exchange Control Activities, during the year ended 31 December (e)	8,943	17,552
Payment for Goods and Services and Taxes, during the year ended 31 December (f)	599,684	847,278
Paid Surplus to Government, during the year ended 31 December 2010 (Note 23)	15,000,000	20,000,000
Advances to Government, as at 31 December 2010 (Note 7)	77,878,823	73,880,500
Government Securities held for specific purposes	1,272,621	1,497,973
Gross foreign exchange transactions during the year, (h)		
Sales	135,934,558	94,689,937
Purchases	30,697,765	89,021,263
SWAP - USD LKR Sell - Buy	115,551,442	21,876,817
Refinances (i)	3,425,470	781,958
RTGS Balances	58,100,434	44,057,928
Assets received without any consideration from the Ministry of Finance	4,500	-
Loans given under Susahana 1 & 2 & Provincial develop. Credit scheme	2,272,362	847,065
Advance payment to CWE for the acquisition of National Mutual Assurance Building	175,000	175,000
Comensation & Interest on land acquired by Govt.- Southern Provincial Office	7,640	-
Face value of EPF Bond Borrowing & Commission payment	108,502,077	-
Receivable from treasury and other ministries	2,377,257	63,194

a) The Domestic Operations Department performs its direct functions of implementing the bank's monetary policy mainly through open market operations as per the sections 90-92 of Monetary Law Act No 58 of 1949 as amended (MLA) and enforcing Statutory Reserve Requirement as per the sections 93-98 of MLA and functions as the banker to both commercial banks where government has shareholdings and certain other financial institutions and governmental entities. The aggregate balances arising from this function as at 31 December 2010 are given in Note 17 and 18. Interest earned on the investment portfolio is given in Note 24.

b) Empowered by the sections 28-33 of the MLA the bank Supervision Department of CBSL carries out the regulatory and supervisory functions of the banks licensed by the Monetary Board of Central Bank. As at 31 December 2010, 11 licensed commercial banks which had been funded by the government or has a significant influence, came under the supervision of the department.

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

- banks, Non-bank Financial Institutions are under supervision.
- c) As per the Section 113 of MLA, the Monetary Board and the CBSL are vested with the function of public debt management. Accordingly, as the agent of the government, the Public Debt Department (PDD) issues securities to the domestic market to meet the budgetary requirements and services both foreign and domestic debt. The PDD deals with public debt management and debt market development. It manages the government debt to ensure that financing needs of the government and its payment obligations are met.
- d) The bank has the sole right and authority to issue currency in Sri Lanka as per section 49 of the MLA. Accordingly, the Currency Department of CBSL functions as the sole issuing authority of the legal tender in Sri Lanka. Printing of the currency notes is carried out by De La Rue Lanka Currency and Security Print (Pvt) Ltd., of which 40% shareholding is owned by the Government.
- e) The management and regulation of receipts and payments of foreign exchange into and out of the country is the key function of the Exchange Control Department. In carrying out such functions, the penalties imposed are collected on behalf of Ministry of Finance to be credited to the Consolidated Fund of the Government. At the end of year 2010 outstanding balance of Exchange control penalties payable was Rs. 8.943 Mn (2009 - Rs.17.552 Mn)
- f) In carrying out the normal operations, the bank enters into transactions to obtain various goods and services with government entities or entities in which government has significant influence or control.
- g) 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 40.
- h) International Operations Department of the bank monitors the development in the domestic foreign exchange market and overnight net foreign exchange open positions of commercial banks. In monitoring the domestic foreign exchange market developments, the bank is on both sides of the market to moderate the excessive volatility in the exchange rate of Sri Lanka Rupee. The amounts of purchases and sales of foreign exchange represents results of such monitoring activities.
- i) The Bank also had custodial arrangements with one State-controlled bank, for which no charges were levied.
- j) The Bank provides refinance loans and for which credit guarantees also provided as described in note 39.2 of which CBSL funded projects amounted to Rs. 3,425.470 Mn (2009 Rs 781.958 Mn) and government funded projects amounted to Rs. 2,751.978 Mn (2009 Rs. 2,970.030 Mn)
- k) As per the circular issued by Director Bank Supervision, the banks who do not maintain the minimum advance limit of 10% to agriculture, contribute the shortfall to refinance fund operated by Regional Development Department of the bank. Accordingly during the year HDFC bank has remitted for Rs.389 Mn of which Rs.72 Mn funds were transferred back to the respective bank.

### **38.2. Transactions with Other Entities in which the Bank has Significant Investments**

During the year the Bank received an amount of Rs. 6.944 Mn (2009 – Rs. 25.163 Mn) as dividend income from its investments given in Note 9.

### **38.3 Transactions with Key Managerial Personnel**

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

**Compensations to the Key Management Personnel**

	2010 Rs 000	2009 Rs 000
Short Term Employee Benefits	73,833	57,641

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

**38.4 Other Transactions with Key Managerial Personnel**

	2010 Rs 000	2009 Rs 000
Loans to Key Management Personnel	27,123	13,536

All the loans are adequately secured and carry interest rates ranging from 2%-19% depending on the loan category and are repayable monthly.

**38.5 Transactions with Post Employment Benefit Plans**

	2010 Rs 000	2009 Rs 000
Contributions paid and payable	26,949	20,605

The bank contributed various amounts to Pension and Other Post Retirement Plans as disclosed in Note 36 and there was no necessity to make an interest subsidy payment to the Employees Provident Fund (EPF) in 2010 as the fund recorded a surplus return. 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 19.

**39. Contingent Liabilities and Capital Commitments****39.1 Financial Guarantee Contracts**

The bank acting as an agent of the government or its agencies and institutions, provides guarantees to various parties on the strength of counter guarantees issued to CBSL by the General Treasury. There were no such outstanding guarantees as at 31 December 2010.

**39.2 Credit Guarantees**

The Regional Development Department (RDD) of the bank performs the functions of providing refinance out of loan proceeds from external lines of credit to participating financial institutions for financing small

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

Local commercial banks - in respect of credit guarantees:

	Currency of Guarantee	Outstanding Guarantee Amount	
		2010 Rs. 000	2009 Rs. 000
<b>Related Parties</b>	Rupees		
- CBSL Funded Projects		717,273	213,659
- GOSL Funded Projects		1,078,177	934,594
<b>Others</b>	Rupees		
- CBSL Funded Projects		557,552	1,387,591
- GOSL Funded Projects		287,211	326,457
<b>Total Credit Guarantees</b>		<u>2,640,213</u>	<u>2,862,301</u>

**39.3 Fiduciary Activities**

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

**39.4 Legal Claims**

The bank is a defendant in 07 cases where legal actions instituted by stakeholders of entities involved, claiming Rs.46.194 Mn with legal interest. These cases are being contested by the bank and no provision has been made in the financial statements.

Further, there were a number of legal proceedings



outstanding against the bank as at 31 December 2010. No provision has been made, as the bank is of the opinion that it is unlikely that any significant loss will arise.

### 39.5 Commitments

- a) As at 31 December 2010 the bank has capital commitments of Rs. 54.134 Mn (2009 – Rs. 51.230 Mn), in respect of the acquisition of Property, Plant and Equipment.
- b) As at 31 December 2010 there were no outstanding Forward exchange transactions and in the year 2009 Bank has entered into Forward contracts amounting to USD 245 Mn & JPY 0.5 Mn.

### 39.6 Assets Pledged

In order to facilitate the securities settlement process, AUD 39 Mn & GBP 10 Mn (carrying value AUD 21.096 Mn & GBP 10.031 Mn) worth of securities (2009– AUD 39 Mn & GBP 10 Mn -carrying value -AUD - 36.953 Mn & GBP 10.223 Mn) have been pledged by the bank to the Euro Clear Bank and obtained a credit facility of USD 35 Mn (2009 – USD 35 Mn). The pledged securities are held in a separate account at the Euro Clear.

### 39.7 Contingent Liability against Sovereign Residencies

As per the lease agreement entered between the Monetary Board of the Central Bank of Sri Lanka (CBSL) and S.W.R.D.Bandaranayake National Memorial Foundation to operate Sovereign Residencies, the subsequent investments made by the lessee to the premises should be agreed by both parties and be recorded. In the event the agreement is terminated the CBSL, as the lessor would have to pay an agreed percentage of the value of the investment based on the year of operation. At the end of the December 2010 the contingent liability of the CBSL as the lessor is estimated at Rs. 21.932 Mn (2009- Rs. 26.319 Mn) being the 50% of the investment value considered at the end of second year of operation.

## 40. Trust and Custodial Activities

Bank commonly acts as a trustee and in other fiduciary capacities that result in the holding or placing of assets

and liabilities on behalf of government, trusts, retirement benefit plans and other institutions. The significant trust activities performed by the Bank are as follows:

- a) The bank handles disbursements and repayments of various foreign loans and, grants under foreign funded development projects and credit schemes on behalf of the Government of Sri Lanka (GOSL). It also collects counter party funds under various foreign loans and grants on behalf of GOSL and invests such funds in treasury bills on requests made by donor agencies.
- b) Bank is the custodian of the Employees Provident Fund (EPF). In terms of the statute, the functions of the Monetary Board consist of receiving contributions, surcharges, income from investments, maintaining proper accounts of registered members of EPF, investing surplus funds and payment of benefits to the members.
- c) Bank administered the Deposit Insurance Scheme, which was a voluntary deposit insurance scheme open to banking institutions licensed by the CBSL and cooperative societies registered under the Cooperative Societies Law No 5 of 1972, which carry on banking business & with effect from 01st October 2010 funds have been transferred to the Sri Lanka Deposit Insurance scheme which was formed as per gazette no:1673/11 -28 September 2010.
- d) Bank carries out regulatory and supervisory functions in respect of registered finance companies (FCs) and attends to related matters under the authority delegated to it by the Monetary Board. While carrying out such functions, with respect to failed FCs, various actions are taken, including the vesting of assets of persons responsible for the unviable and insolvent condition of such companies, with the Monetary Board as a form of security.
- e) As per the gazette no:1673/11 dated 28th September 2010, bank has established a Mandatory Deposit Insurance Scheme, namely Sri Lanka Deposit Insurance Scheme w.e.f 01st

October 2010. All licensed commercial banks, licensed Specialized banks (LSBs) & registered finance companies shall be the members of this scheme. The deposit to be insured include demand, time & savings, deposit liabilities of the member institutions excluding all borrowing instruments are insured with specific exclusions as per 5.2 of the said gazette notification. A Deposit Insurance Fund has been created with the transfer of Rs. 331.653 Mn of the investments of Voluntary Deposit Insurance Scheme & Rs. 282.337 Mn of investments made out of collections from LCB's as abandoned property. The amount of compensation payable to a depositor shall be limited to Rs. 0.2 Mn or its equivalent in the case of foreign currency deposits if such amount exceeds Rs. 0.2 Mn.

The payment of compensation shall not be a liability of the Monetary board or the Central Bank of Sri Lanka, & shall be limited to funds available or raised in the Deposit Insurance Fund including any borrowings permitted & contributions received. The Monetary Board & the Central Bank of Sri Lanka shall not be responsible for any liability that exceeds the total amount lying to the credit of the fund.

The unit established in the Bank Supervision Department, is responsible for operation &

management of the scheme and maintain separate books & accounts distinctly separate from the Financial statements of the bank & the Auditor General should be the Auditor.

- f) As per the circular issued by Director Bank Supervision, the banks who do not maintain the minimum advance limit of 10 % to agriculture, are required to contribute the shortfall to refinance fund operated by Regional Development Department (RDD) of the bank. RDD refines such amounts collected through bank of ceylon & Peoples' bank to agriculture under Viskam refinance scheme. The total collections outstanding as at end of the December 2010 amounted to Rs. 732 Mn. As at the year end RDD has not granted any loans under the refinance scheme & held Rs. 780.268 Mn of investments in govt. securities. Further Rs. 48.942 Mn of income earned from the investments.
- g) Regional Development Department of the bank on behalf of the Monetary Board acts as the exclusive agents with regard to the following foreign funded projects. In which required the Monetary Board enters into an agreement with the government of Sri Lanka clearly demonstrating the rights and obligations of the bank.

**Concluded Projects for all sectors in the country**

Name of the Project	Total allocation of the fund (Mn)		Purpose of the loan	Refinance granted to PFI s (Rs. Mn)	Salient Features	Warranties & Assurance	General Conditions	Special Conditions
Tea Development Project	USD	24.50	Increase tea small holders income and improve the natural environment in the project areas	2550.90	Collection of refinance from PFIs as per scheduled date and transferred to DST on conclusion	No warranties and assurance	Financial Statements should be audited by external auditors	The rights and obligations of the agreements will not be assigned, amended, abrogated or waived without the agreement of all relevant parties
Second Perennial Crop Development project	SDR	11.562	Commercialization of the perennial crop sector, increase production, nursery development post harvest handling, processing and marketing	1453.11				
Plantation Sector Reform Project	USD	40.00	To support policy and institutional reforms in the tree crop sub-sector to increase the productivity and profitability and maintain the competitive advantage of the tree crop industry of Sri Lanka.	5200.00				
Susahana loan scheme	LKR	30,000.00	Resumption of enterprises affected by tsunami	2,750.00	When recovery received from PFIs, funds should be transferred to FD			
Susahana Finance & Leasing Co.	LKR	352.69	Resumption of enterprises affected by tsunami	351.06	Collection of refinance from PFIs as per scheduled date and transferred to DST on completion			
Small business Revival Programme	LKR	2656.00	Resumption of SMEs affected by tsunami	2663.40				
Small business Revival Programme Revolving Fund	LKR	150.00	Resumption of SMEs affected by tsunami	122.72				
Skill Development Project	LKR	94.31	Improve quality and relevance of skill training programme to build a high quality workforce and address skill mismatching	94.59				
Urban Environment Infrastructure Development Project	USD	4.00	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, renovation and expand their residency.	1362.00				
Urban development low income housing project	SDR	15.095	To provide capital to support low income households for housing improvement	1915.76				
North western province water resource development project	USD	1.80	Improve economic, social and nutritional well-being of the people living in the project areas	102.76				
Mathale regional economic advance project	SDR	2.00	Permanent rising and sustaining of income of small entrepreneurs	249.06				
Mid country perennial crop development project	SDR	11.56	As the production of perennial crops in the mid country area.	642.00				
Agriculture rehabilitation project	SDR	17.052	To rehabilitate persons and property affected by the civil disturbances in the Northern and Eastern provinces and five bordering districts.	843.00				
Small holder tea development project	USD	12.60	To develop small holder tea sector and rehabilitate tea facilities.	645.93				
Poverty alleviation micro finance project	YEN	1368.00	Setting up of an effective credit delivery mechanism for channelling formal credit to income generating activities	1402.45				
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	408.24				
Small farmers landless credit project revolving fund	LKR	310.17	To establish a cost effective and sustainable micro credit delivery system to generate employment and improve saving habits among the low income receiving people.					
Kegalle integrated rural development project	SDR	1.50	Uplift the standard of living of the people in the project areas by promoting income generating activities	148.00				
Southern province rural development project	SDR	27.903	Improve the quality of the life of the people in the southern province	564.00				

Ongoing Projects	Total allocation of the fund (Mn)		Purpose of the loan	Refinance granted to PFIs (Rs. Mn)	Salient Features	Warranties & Assurance	General Conditions	Special Conditions	
Viskam Loan scheme	LKR	732.00	To ensure the availability of credit for investment, diversification and improvement of commercial agri business activities. (development of commercial agri business activities).	0	After concluding the projects, funds should be transferred to PFIs as per instructions given by the D/BSD	No warranties and assurance	Financial Statements should be audited by external auditors	The rights and obligations of the agreements will not be assigned, amended, abrogated or waived without the agreement of all relevant parties	
Post Tsunami Coastal Rehabilitation Resource management project	SDR	1.02	To support income generating activities directly & indirectly affected by tsunami.	0	Collection of refinance from PFIs as per scheduled date and transferred to DST				
Krushi Navodaya	LKR	3,000.00	Provisioning and capital to improve the agriculture base income generating avenues.	2334.85	Subsidy scheme (subsidy paid by the GOSL to PFIs)				
Abiurdhi loan scheme	LKR	5,000.00	To develop daily farming, milk processing industries, agriculture crop processing industries, cold stores & block ice manufacturing plants and poultry sector.	1163.86	Subsidy scheme (subsidy paid by the GOSL to PFIs)				
Saubagya Loan scheme	LKR	500.00 (Initially transferred)	To startup, expand any MSMEs or re-start the disaster affected MSMEs	463.10	Collection of refinance from PFIs as per scheduled date and transferred to relevant accounts of the RDD on completion				
Self employment promotion initiative loan scheme	LKR	44.50	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	10.20	Collection of refinance from PFIs as per scheduled date and transferred to DST on completion				
Small plantation Entrepreneurship development loan scheme	SDR	1.75	To enhance the living standard of the low income community in Nuwara Eliya, Kandy, Kegalle and Moneragala.	2.82					
Sabaragamuwa province intergrated rural development project phase i	LKR	70.00	To enhance and start new income generating activities in the Sabaragamuwa Province	35.11					
Sabaragamuwa province intergrated rural development project phase ii	LKR	70.00	To enhance and start new income generating activities in the Sabaragamuwa Province	77.75					
Mathale Regional Economic Avancement project revolving fund	LKR	77.00	To raise the income of rural and farm families and to provide funds for medium scale entrepreneurs to create non-farm enterprises and to expand existing projects as well in the Matala District.	65.42					
Tea development project revolving fund	LKR	1,100.00	To development of the tea sector in the country	718.95					
Second perennial crop development project revolving fund	LKR	1,000.00	To provide credit facilities to perennial crop sector in the country.	913.83					
EIB contract B loane scheme	EURO	10.00	To reconstruction of SMEs directly affected by tsunami.	1476.76					
Construction sector development project	EURO	9.00	To strengthening the financial and technical capacities of private local businesses to effectively participate in construction and public works in post tsunami reconstruction.	1339.73					
Susahana II	LKR	500.00	Provide credit facilities to resume MSMEs affected by the tsunami.	105.54					Funds should be transferred to FD
Awekening North	LKR	2,000.00	To develop micro and small enterprises located in the Northern Province	1278.00					Collection of refinance from PFIs as per scheduled date and transferred to relevant accounts of the RDD
Development of Eastern Province	LKR	1,000.00	To develop micro and small enterprises located in the Eastern Province	743.40					
Provincial Development	LKR	2,900.00	Provisioning capital to medium and long-term projects in the SME sector in the country.	1184.50	Funds should be transferred to Finance Department				

**41. Events Occurring Subsequent to Balance Sheet Date.**

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

## 2. BANK SUPERVISION

The Bank Supervision Department (BSD) was established under Section 28(1) of the Monetary Law Act to carry out continuous supervision and periodic examination of commercial banks licensed by the Monetary Board. The supervisory responsibilities of BSD have evolved to include formulating and implementing prudential regulations, conducting continuous supervision and periodic statutory examinations of banks to ascertain their true positions, processing requests for regulatory approvals, and administering the mandatory deposit insurance scheme. These regulatory and supervisory functions of BSD are focused on ensuring the safety and soundness of the banking system and safeguarding the interest of depositors and other creditors of the bank. There were 31 banks, comprising 22 Licensed Commercial Banks (LCB) and 9 Licensed Specialised Banks (LSB) in operation under supervision of the BSD as at end 2010. The names of these banks are provided in Annex II-1. A summary of the main activities performed by BSD during 2010 are provided below.

### 2.1 Prudential Regulations to Strengthen Risk Management

New prudential regulations and several amendments to existing regulations to licensed banks were introduced with the approval of the Monetary Board in 2010, details of which are provided in Part III of this Report. A summary of the major prudential regulations is given below.

- (a) **Increase in minimum capital requirement:** With a view to promoting the existence of strong banks resilient to internal and external shocks, the minimum capital of new licensed commercial banks and licensed specialised banks was increased to Rs. 5 billion and Rs. 3 billion, respectively, by 2014. The existing banks are required to achieve these targets by 31 December 2015.
- (b) **Listing of banks in the Colombo Stock Exchange:** In order to enhance the ability of banks to raise capital in a more transparent manner and to improve the governance through market discipline, the unlisted locally incorporated private banks were required to obtain a listing in the Colombo Stock Exchange by 31 December 2011.
- (c) **Reduction of interest rates:** All banks were requested to take appropriate measures to reduce interest rates on housing loans to 14 per cent per annum, interest rates on credit card advances to 24 per cent per annum and interest rates on other loans and advances by 1 per cent-2 per cent per annum by end of October 2010.
- (d) **Reduction in general provisions:** Considering the improved conditions in the banking sector, the general provision requirement was reduced from 1 per cent to 0.5 per cent on a staggered basis at a rate of 0.1 per cent per quarter, commencing from the quarter ending 31 December 2010, and ending by 31 December 2011.
- (e) **Relaxation of loan classification, income recognition and provisioning requirements:** In order to facilitate the revival of businesses and new viable projects, the direction was temporarily relaxed till June 2011 to permit banks to provide credit facilities to borrowers for repayment of non-performing loans and for business purposes without requiring the new facility to be classified as non-performing loans, subject to certain conditions.
- (f) **Introduction of the Sri Lanka Deposit Insurance Scheme:** As a measure to improve the financial safety net, a mandatory deposit insurance scheme titled 'The Sri Lanka Deposit Insurance Scheme' was implemented under the provisions of the Monetary Law Act with effect from 1 October 2010, replacing the voluntary deposit insurance scheme. The main features of the scheme are as follows:
- Members of the scheme - all licensed banks and registered finance companies.
  - Eligible deposits - all demand, time and savings deposit liabilities of member institutions excluding deposits of member institutions, Government of Sri Lanka, directors, key management personnel and other related parties, deposits held as collateral against any accommodation granted and deposits falling within the meaning of abandoned property in terms of

the Banking Act and dormant accounts in terms of the Finance Companies Act.

- Insurance premium on eligible deposits - range between 0.10 per cent and 0.15 per cent per annum and to be paid by member institutions on a monthly/quarterly basis to the Deposit Insurance Fund (DIF) maintained at the Central Bank. The balance in the DIF as at 31 December 2010 was Rs. 1.48 billion, consisting of premiums of member institutions amounting Rs. 32.3 million, Rs. 1.1 billion transferred from abandoned property of licensed commercial banks and Rs. 350.2 million transferred from the voluntary deposit insurance scheme.
  - Investments - Funds in the DIF shall be invested in Government securities and loans to member institutions as may be decided by the Monetary Board. As at 31 December 2010, a total of Rs. 1.39 billion had been invested in such Government Securities.
  - Compensation - In the event the licence or registration of a Member Institution is suspended or cancelled by the Monetary Board, compensation will be paid up to a maximum of Rs. 200,000 per depositor, commencing from 1 January 2012.
- (g) **Outsourcing of business operations:** Directions were issued to banks to regulate the practices of banks on outsourcing of operations. Outsourcing of acceptance of deposits; assets and liabilities management; compliance; customer due diligence and KYC; treasury functions; risk management; and sanctioning of loans except facilities based on pre-approved (i.e. Board approved) criteria are not permitted.
- (h) **Introduction of the assessment of fitness and propriety of officers:** A determination was issued requiring to assess the fitness and propriety of officers performing executive functions in licensed banks in terms of Section 44A of the Banking Act.
- (i) **Increase in the annual licence fee:** The annual licence fee, which was Rs. 1 million for LCBs

performing domestic banking business including foreign exchange and off-shore banking business, Rs. 600,000 for LCBs performing off-shore banking business only, and Rs. 300,000 for LSBs, was increased to be levied on the basis of the total assets of the banks at the end of the previous year, as indicated in the following table. Accordingly, a total of approximately Rs. 168 million is expected as licence fees for the year 2011.

Total assets as at the end of previous year	Annual Licence Fee (Rs. Million)
Above Rs. 75 billion	10
Rs. 25 billion to Rs. 75 billion	5
Less than Rs. 25 billion	2

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

- (a) During the year, approvals were granted for opening 61 new branches, 95 other banking outlets such as Extension Offices (EOs) and Student Savings Units (SSU), relocation of 10 EOs, upgrading of 7 EOs to fully fledged branches and installation of 5 off-site Automated Teller Machines (ATMs). These include approvals for opening 61 branches in the Northern and Eastern provinces. Accordingly, at the end of 2010, there were 1,930 branches, 3,941 other banking outlets and 2,006 ATMs in operation.
- (b) A specialised banking licence was issued in July 2010 to 'Pradeshiya Sanwardana Bank', a state owned bank, subsequent to vesting of the businesses of the six Regional Development Banks. The validity period of the letter of provisional approval issued to Axis Bank Limited in Mumbai, India, for setting up a branch in Sri Lanka was extended till 30 June 2011.

## 2.3 Continuous Supervision of Banks

Continuous supervision is an ongoing monitoring mechanism on the affairs of individual banks which serves as an early warning system to identify adverse conditions of banks that need further examination and corrective actions. Preparation of reports on specific issues such as the exposure to the top 20 corporate customers of small

banks; the banks' exposure to subsidiaries, associates, other investee entities and top 20 groups/customers; lending by banks in the Northern and Eastern provinces and follow-up on non-compliances with requirements and corrective action on key supervisory concerns were undertaken. Further, an early warning system with a list of key trigger points was developed to identify any variations or areas of concern on a daily basis. Several meetings with Boards of Directors, senior management and external auditors of banks were also held in 2010 to facilitate this mechanism.

#### **2.4 Examination of Banks**

BSD continued to carry out periodic examinations of banks by adopting a risk based approach focusing on identification of risks, management of risks and assessment of resources to mitigate risks. BSD conducted examinations of 18 banks that continued from the previous years and examinations of 16 banks that commenced in 2010. Accordingly, the examinations of 16 banks were completed in 2010 through formal discussions with the management of the respective banks and submission of reports to the Monetary Board, while 18 examinations were in the process of completion. In addition, several examinations of limited scope were also carried out by BSD on timely issues such as non-compliance with prudential regulations.

#### **2.5 Bank Chief Executive Officers' Meetings**

BSD functions as the secretariat for the Governor's monthly meetings with the Chief Executive Officers (CEOs) of licensed banks. This serves as a forum for exchanging views on prudential regulations, policies, current developments and other issues pertaining to the banking industry. At these meetings, CEOs were apprised of the banking sector performance and economic and monetary developments to facilitate their decision making. Some of the matters discussed at these meetings were adoption of Sri Lanka Accounting Standards 44 and 45, improvements to Corporate Governance in banks on disclosures and internal controls, requirement to enhance lending to the SME sector, assessment of the fitness and propriety of officers performing executive functions, implementation of the mandatory deposit insurance scheme, the need to

enhance ethical banking practices, the need to expand credit to the private sector and reduction of interest rates.

#### **2.6 Other Activities**

##### **(a) Adoption of Sri Lanka Accounting Standards (SLAS) 44 and 45**

During 2010, the Central Bank continued to facilitate the adoption of SLAS 44 and 45 by banks, corresponding to International Accounting Standards (IAS) 32 and 39. Accordingly, the Committee comprising representatives from Sri Lanka Banks' Association (SLBA), Institute of Chartered Accountants of Sri Lanka (ICASL) and bank auditors continued to meet to discuss issues in relation to the transition to the new accounting standards. In response to the Central Bank's request from the World Bank, technical assistance was provided on practical experience of other countries and tax implications when adopting SLAS 44 and 45. Banks carried out an impact assessment of the transitional provisions. The Central Bank as a facilitator for the adoption of SLAS 44 and 45 held a workshop to address gaps in terms of policies, systems and procedures and conversion of historical cost based financials. Further, a panel of auditors was requested to facilitate the adoption of the new standards in banks.

##### **(b) Monitoring of Mandatory Lending to Agriculture Sector**

The mandatory lending requirement of minimum 10 per cent of lending to the agriculture sector was monitored by BSD on a quarterly basis. The Monetary Board required the banks that are non-compliant with this requirement since end 2009, to contribute any shortfall of the requirement to a refinance fund "Special Loan Scheme for Agriculture Sector Development" operated by the Regional Development Department for lending to the agriculture sector through other banks. Further, BSD required all banks to assess their position on lending to the agriculture sector quarterly and credit funds equivalent to any shortfall on the



requirement to a refinance fund within 15 days from the end of each quarter.

**(c) Proposed Amendments to the Banking Act**

BSD has initiated amendments to the Banking Act with a view to further strengthening the supervisory and regulatory framework of licensed banks in line with international best practices. The proposed amendments will entail changes to align the provisions of the Banking Act with those of the Companies Act No. 7 of 2007 and to facilitate current developments in the banking sector in relation to consolidation and mergers of banks, strengthening bank resolution measures and strengthen the Central Bank's capacity to supervise bank dominated financial groups on a consolidated basis. The proposed amendments have been discussed with the banking industry and are expected to be finalized soon.

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

The Director of BSD continued to be a member of IRIC, whilst the Additional Director of BSD was appointed as Secretary to IRIC in 2010. The main responsibilities of IRIC are to ensure the formation of appropriate policy directions for the orderly development of the financial sector and to ensure that all regulatory agencies coordinate and exchange information in the interest of the wider financial system stability. Key matters discussed at this forum included the introduction of a law for sharing of information among financial sector regulators, amendments to Section 12(1C) of the Banking Act, development of the capital market and new regulatory measures introduced by the Securities and Exchange Commission.

**(e) Actions on Prohibited Schemes and Litigation**

BSD continued with its investigations into the operations of prohibited schemes in terms of Section 83C of the Banking Act. In this regard, a Procedures Manual for identifying, determining and prosecution of prohibited schemes was adopted in consultation with the Hon. Attorney General. BSD conducted investigations into the business

activities of 3 suspicious companies in accordance with the said Manual and the provisions of the Banking Act and determined that one company, namely Tiens Lanka Healthcare (Pvt) Ltd., had operated a prohibited scheme. BSD also handled 9 cases under prosecution in Magistrates courts in Anuradhapura, Balapitiya, Maho, Panwila, Kurunegala, Attanagalla and Minuwangoda in association with law enforcement authorities. BSD handled 27 court cases in the Supreme Court, Court of Appeal, District Court and Labour Tribunal in 2010. During the year, 4 cases were dismissed while 3 cases were withdrawn by the petitioners. As at the end of 2010 there were 20 pending cases.

**(f) Awareness Programmes**

The third Bank Directors' Symposium on the theme "Repositioning Banking towards a Higher Growth Path" was conducted by BSD in December 2010, with a view to enhancing bank directors' awareness on their responsibilities and to update them on new developments in the banking industry and regulatory environment. It also continued to conduct public awareness programmes to educate the public on the safety of their transactions with financial institutions. Accordingly, print and electronic media advertisements in Sinhala, Tamil and English on the list of institutions authorised to accept deposits and fraudulent methods of prohibited schemes of pyramid nature were published at a cost of Rs. 21.5 million.

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

**Licensed Commercial Banks**

01. Bank of Ceylon
02. Citibank, N.A.
03. Commercial Bank of Ceylon PLC
04. Deutsche Bank AG
05. DFCC Vardhana Bank Ltd.
06. Habib Bank Ltd.
07. Hatton National Bank PLC
08. ICICI Bank Ltd.
09. Indian Bank
10. Indian Overseas Bank
11. MCB Bank Ltd.
12. National Development Bank PLC
13. Nations Trust Bank PLC
14. PABC Bank PLC
15. People's Bank
16. Public Bank Berhad
17. Sampath Bank PLC
18. Seylan Bank PLC
19. Standard Chartered Bank
20. State Bank of India
21. The Hongkong & Shanghai Banking Corporation Ltd.
22. Union Bank of Colombo Ltd.

**Licensed Specialised Banks**

01. DFCC Bank
02. Housing Development Finance Corporation Bank of Sri Lanka
03. Lankaputhra Development Bank Ltd.
04. MBSL Savings Bank Ltd.
05. National Savings Bank
06. Pradeshiya Sanwardana Bank
07. Sanasa Development Bank Ltd.
08. Sri Lanka Savings Bank Ltd.
09. State Mortgage & Investment Bank

### 3. CENTRE FOR BANKING STUDIES

Year 2010 saw the Centre for Banking Studies (CBS) of the Central Bank of Sri Lanka (CBSL) continued to establish itself as a frontline centre for knowledge sharing in the South Asian Region. The blend of local and international workshops, seminars, conferences and other knowledge sharing programmes rolled out by the CBS during the year 2010 were patronized by a diverse range of participants from the financial sector and real sector institutions, followers of tertiary education and the general public.

A total of 103 programmes which consisted of 61 calendar programmes, 34 special programmes (based on demand by various institutions), and 8 international programmes were conducted during 2010. These programmes were patronized by a total of 2,962 participants consisting of both local and foreign personnel. A noteworthy fact during the year 2010 was the resounding success of the new programmes, which were designed to reach beyond the boundaries of the financial sector. These programmes, which were previously limited only to those in the financial sector, opened the doors of CBS to participants from a diverse range of organizations.

Keeping in line with its social responsibility objectives, CBS continued to successfully carry out its Public Lecture programme during 2010. A series of 11 public lectures and 6 evening presentations were conducted for the general public by inviting eminent resource speakers from Sri Lanka as well as from foreign countries. In addition, 25 special educational programmes were conducted for University academics/ students, school children and teachers with a view to enhancing the knowledge of the CBSL stakeholders.

Another landmark for CBS in the year 2010 was the release of its first research journal "The CBS Journal of Multidisciplinary Studies". This research journal, containing research studies related to different disciplines, was made public during the latter part of 2010. The journal will be released on an annual basis further signifying the commitment of CBS in its journey towards a Centre of Excellence in creating and sharing knowledge in the region.

Continuous improvements in the quality of the programmes which are being offered and the enhancement of infrastructure facilities during the past year have immensely contributed towards establishing a better learning environment at CBS. The leadership initiatives taken by CBS in human capital development in the financial sector during the past years were recognized and rewarded by its stakeholders. CBS received the Asia's 'Best Business School Leadership Award' in the Banking and Finance Training Institution Category at the Asia's Best Business School Awards organized by the CMO Asia Council, in Singapore.

#### 4. COMMUNICATIONS

The year 2010 was an extraordinary year for the Communications Department (CMD). It played a pivotal role in arranging various events related to the 60th Anniversary celebrations. The Department exploited this opportunity to strengthen the image of the Central Bank of Sri Lanka (CBSL) among its stakeholders. Publication of the coffee table book, named Central Bank of Sri Lanka- Retrospect 1950-2010, was one of the most talked about items in the anniversary year agenda. The book contains a mosaic of news articles with images extracted from newspapers since 1950, pictorially depicting the evolution of the CBSL in the context of the socio-economic background of the country. Econ- Icon, an inter school quiz programme produced in association with Sri Lanka Rupavahini, was one of the other major events handled by the CMD. This attractive TV-show, helped expose the general knowledge of the student community on economics and central banking. Produced in Sinhala and Tamil, competing schools for the TV rounds were selected through written tests conducted island-wide. The department could successfully conduct both these massive projects with the collective support extended by all the departments in the Bank.

##### 4.1 External Communication

As in the previous years, CMD provided real time information to all its stakeholders on the policies and strategies taken by the CBSL for achieving a stable financial system, stability in the price levels and higher economic growth.

CBSL extensively used its trilingual website maintained in English, Sinhala and Tamil for external communication. The CBSL website was revamped with a face lift adding Real Simple Syndication (RSS) facility and a video clip page. When compared to the previous year, no of hits to the CBSL website increased by 8 percent to 58.1 mn in 2010 from 53.7million in 2009. In addition to supplying regular information through the website, on-line sales of commemorative coins and CBSL publications continued throughout the year.

As in the past, the Department continued to release information on daily exchange rates, weekly and monthly economic indicators, Sri Lanka Inter Bank Offered Rates, oil prices, consumer price indices and information on Government Securities such as Treasury Bills and Treasury Bonds auctions. During the year CMD issued 1,722 press releases, 490 newspaper advertisements and 15 Gazette notifications. In addition to regular press releases and notices, CMD organized 62 media conferences and a number of one-on-one media interviews with the senior officials of the CBSL to enhance public awareness on various economic and financial issues. CMD's media unit also covered all official visits of the Governor.

##### 4.2 Internal Communication

With the aim of enhancing internal communication requirements of the staff, the Department continuously updated the 'CBSL daily' web-portal which provides the Bank's staff with current information related to local and foreign news, banking and finance, important economic indicators, presentations, announcements and notices. New features were added to the internal magazine "Kauluwa" providing opportunities for employees, associations and societies operating in the CBSL to express their views and ideas on various topics.

Help Desk services to enhance public consciousness especially on the non-banking financial sector was continued during the year. In addition, Help Desk responded to 516 e-mails received from domestic and international sources and over 6500 telephone enquiries.

The corporate management was provided daily with a collection of news, articles and public opinions on the economy and the CBSL related news published in the national newspapers. A total of 1,714 such news items on various economic, financial and social issues were submitted to the management.

### 4.3 Public Awareness

As a means of increasing public awareness on forged currency notes, fraudulent and illegal transactions, a documentary on identifying forged currency notes and two commercials on pyramid schemes were produced. Brochures and leaflets for awareness programmes on clean note policy were also released. 38 public awareness programmes and school seminars on economics, banking and finance were conducted during the year to educate the general public on central banking issues. CMD also arranged visits to the CBSL by school children and teachers especially from the Northern and Eastern provinces, for trainees from military services and for the business community.

The CMD participated in several national and regional level exhibitions and other public events to enhance public awareness on economics and finance, and on policies and responsibilities of the CBSL. The stalls of CBSL at the Colombo International Book Fair and 'Deyata Kirula' exhibitions recorded a significant public participation. Participation at these exhibitions provided CBSL with an opportunity to enlighten the public on CBSL concerns and to sell a large number of CBSL's publications. Sales and distribution activities of the CBSL publications increased by more than 20 per cent over the previous year. The value of sales of publications during the same period increased by 36 per cent to Rs. 6 million. As a means of increasing awareness, CBSL publications were distributed free of charge amongst the government institutions, national libraries, foreign missions, schools and academic institutions. The free distributions increased by 10 per cent when compared with the previous year, mainly driven by the new demand from the Northern and Eastern Provinces.

### 4.4 Translation Services

The Tamil Translation Unit continued to fulfil translation requirements of the CBSL during the year as well by undertaking 284 Tamil translation assignments. In addition, the Tamil version of the CBSL website was also maintained. Most of the CBSL publications such as Annual Report, Press releases, Parliament answers, amendments to Acts, Circulars, Gazette notifications, Auditor General's Report, Financial Statements, web pages were provided in the Tamil version in addition to the Sinhala and English versions.

### 4.5 Printing Press

The Department provided the services of designing, typesetting and printing to meet all the publication requirements of the CBSL. In this respect CBSL's Printing Press completed 252 printing assignments ranging from black and white to 5-colour received from various departments. Step by Step Guide to Doing Business in Sri Lanka, The Sri Lanka Socio-Economic Data, Economic and Social Statistics of Sri Lanka, News Survey, Satahana, Kauluwa, Staff Studies, Financial System Stability Review, Road Map, Strategic Plan, Public Debt Bulletin and research publications are some of the main publications printed by the CBSL Printing Press. Visiting cards, greetings cards, notepads, file covers, CBSL Diary, posters, brochures, leaflets, bulletins, pamphlets and official individual publications were also among other printing assignments undertaken by the Printing Press.

### 4.6 Coverage of Major Events of the Bank

Photographic Unit of the CMD provided coverage for all the major events conducted by the CBSL. Accordingly, 278 photographic events including development activities of the Northern and Eastern Provinces were covered by CMD.

### 4.7 Library and Information Centre (LIC)

The Library and Information Centre (LIC) continued to provide library services to the Bank Staff and others on request. LIC increased its collection of books from 23,476 to 24,313, reports from 15,229 to 17,243 and digital books from 1,430 to 1,603. Bound volumes

numbering 300 were also added to the collection during the year. The Library at the CBSL's Centre for Banking Studies too increased its collection of books from 5,683 to 5,777.

The usage of the 'Science Direct' database which gives on-line access to over 100 journals on Economics, Econometrics and Finance was increased during the period under review. The LIC subscribed to 118 and 51 foreign and local journals, respectively. LIC continued to compile electronic publications such as Recent Additions (i.e. new books), Current Contents, News Alert and disseminated them to staff via the intranet. A Selective Dissemination of Information (SDI) service continued during the year.

In order to encourage bank staff to use on-line library facilities, 7 user education programmes covering 7 departments were conducted. Two documentary films produced on various important topics and subjects were shown during the lunch interval at the Lobby of the LIC for the benefit of the staff. Economics and Banking Library Network of Sri Lanka (EbanklibnetSL) was maintained and its 23 member libraries were benefited immensely by sharing information via e-mail. LIC contributed fruitfully for the compilation of the 60th Anniversary publication of the CBSL, "Central Bank of Sri Lanka: Retrospect 1950-2010" by gathering information relating to key historical events relating to the country and in particular to the CBSL, from newspapers. The Book Review Competition and Quiz Programme by e-mail were popular events organized to mark the National Reading Month in October.

Self Access Language Laboratory housed in the Reference Section of the LIC was made available to CBSL Staff. Library services were maintained in compliance with ISO 9001: 2000 Standard awarded to the LIC in 2008.

## 5. CURRENCY

### 5.1 Currency Issue And Management

During the year, the Currency Department (CRD) continued to perform the functions related to its main

responsibility of currency issue and management to ensure adequate supply of currency in the financial system by issuing currency notes and coins into circulation. The value of currency notes and coins in circulation by end 2010 stood at Rs. 255 billion which is an increase of 17.5 per cent compared to that of 2009. Meanwhile, the value of new and serviceable currency notes issued to commercial banks by the CRD during the year under review was Rs. 88 billion and Rs. 171 billion, respectively. During the year, commercial banks deposited currency notes to the value of Rs. 222 billion with the CBSL. Accordingly, the net issue of currency notes and coins into circulation by end of 2010 stood at Rs. 37 billion and Rs. 416 million, respectively.

The CRD continued to withdraw unserviceable currency notes from circulation to maintain the quality of currency notes in circulation. Commercial banks were encouraged to deposit unserviceable notes with the CBSL in order to implement the Clean Note Policy more effectively. Approximately 128,000 unserviceable currency note bundles (1,000 notes per bundle) were destroyed during the year. A sum of Rs. 28 million was collected in 2010 as service charges on processing deposits of serviceable notes from commercial banks.

### 5.2 Preserving Public Confidence in Currency

The CRD continued to work in close cooperation with the Counterfeit Currency Bureau of the Criminal Investigation Department (CID) to minimize the incidence of counterfeit notes and to preserve the public confidence in currency. The CRD attended 27 court cases relating to counterfeiting during the year. The counterfeit notes detected and referred to the Bank for certification during 2010 was around five notes per million notes in circulation indicating lower level of incidence of counterfeiting compared to many other countries. Awareness programmes on security features of genuine currency notes to law enforcement officers, government officers, cash handlers and the general public were able to increase their knowledge on how to use currency notes effectively. The CRD also introduced advanced security features to the new series of currency notes to prevent counterfeiting.

### 5.3 Promoting Clean Note Policy

Good habits of handling notes, extend the life span of notes and help reduce cost of printing new notes. Further, clean notes help distinguish between genuine notes and counterfeits and to preserve the image of the nation. The CRD continued with issuing new notes into circulation and removing unserviceable notes as part of promoting the Clean Note Policy. In order to ensure adherence to the guidelines issued to commercial banks on sorting standards for currency notes, random samples of currency notes from stock of bundles deposited by commercial banks were checked as a routine measure. In addition, publicity was given through print media to discourage willful mutilation of notes and to promote the use of clean notes among users.

### 5.4 New Projects

Printing of the new series of currency notes (11th series) on the theme "Development, Prosperity and Sri Lanka Dancers" was completed in 2010. The 11th series of currency notes was scheduled to be ceremonially launched on 04.02.2011 by officially handing over a set of the new series of notes by the Governor to H.E. the President, Mahinda Rajapaksa. Comprehensive public awareness programmes through print and electronic media including the issue of brochures, leaflets and posters were initiated with the launch. Special informative materials were prepared to educate bank tellers, cash handlers and law enforcement authorities. In addition, arrangements were made to prepare special collectors' items such as currency note presentation folders, uncut currency note sheets for numismatists and other interested parties.

The third Money Museum of the CBSL was opened on 06.05.2010 at the Provincial Office, Matara. The objective was to facilitate the general public including school children to collect information and develop an interest on currency.

Research activities of the CRD focused on improving lifespan estimates of various denominations of currency notes and estimating currency demand. Outcome of the research was helpful in improving currency management.

### 5.5 Promoting Awareness on Currency

The CRD conducted 40 awareness programmes on the identification of counterfeit notes, clean note policy and re-circulation of coins targeting bank employees, police officers, school children, government officials and the general public through public lectures, seminars and electronic and print media.

The CRD also participated in the following 7 exhibitions with a view to enhancing public awareness on currency and its historical developments.

"Deyata Kirula" National Development Exhibition 2010, at Pallekele, Kandy from 04th - 10th February, 2010.

"Pirihimbini Diyawara" at University of Sabragamuwa, Belihul-Oya from 16th – 19th March, 2010.

"Sisu Nipunatha" at Viharamaha Devi Balika Vidyalaya, Kiribathgoda from 21st – 24th June, 2010.

Exhibition at Taxila College, Horana from 27th September – 03rd October, 2010.

"Savimath Ratak – Isurubara Hetak" at Matara from 19th – 22nd November, 2010.

Exhibition at St. Joseph Girls School, Kegalle from 26th – 29th November, 2010.

"Moratu Udhanaya" held at Prince of Wales College, Moratuwa from 23rd – 27th December, 2010.

### 5.6 Commemorative Coins and Notes

The CRD formulated a policy with regard to issue of commemorative coins and notes, and obtained Monetary Board approval for adoption of same. All requests to mint commemorative coins were attended to meet delivery targets. The CBSL issued its first multi-coloured silver (frosted proof) commemorative coin in the denomination of Rs. 5,000 to mark its 60th Anniversary. Commemorative coins, coin packs and commemorative notes to numismatists and collectors were sold through its counters, museums and at above mentioned exhibitions.

## 6. DOMESTIC OPERATIONS

The Domestic Operations Department (DOD) continued to perform its major functions of implementing the monetary policy of the Central Bank mainly by conducting Open Market Operations (OMO), enforcing Statutory Reserve Requirement (SRR) and serving as the banker to the government and commercial banks.

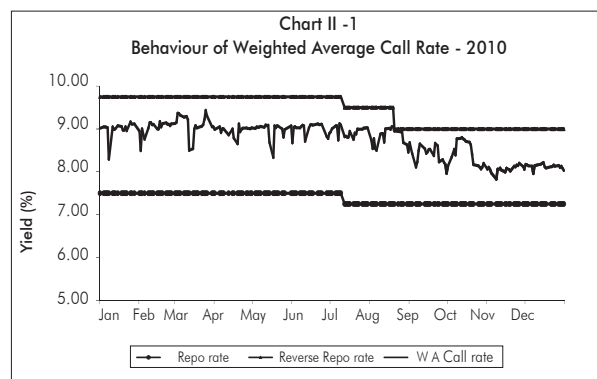
The Department also continued supplementary services of ensuring the availability of funds for settlements to be made under the Real Time Gross Settlement System (RTGS) by providing the Intra-Day Liquidity Facility to commercial banks and primary dealers to maintain efficient, effective and smooth domestic e-payment and settlement system.

### 6.1 Implementation of Monetary Policy

Persistent and relatively high rupee market liquidity was an enormous challenge to the implementation of monetary policy throughout the year 2010. Signs of slow recovery in the countries affected by global financial crisis and rapid phase of development that Sri Lanka is experiencing after 30 years of internal conflict, triggered capital inflows and continued during the first quarter of the year. Stable exchange rate and improved sovereign rating, anchored the investor confidence on Sri Lanka as an investment destination. Improved export proceeds, private remittances and foreign investments in high yielding government bonds and growing share market facilitated further foreign exchange inflows to the country. The intervention by the Central Bank of Sri Lanka (CBSL) in the foreign exchange market has prevented any sharp appreciation of rupee on account of continued inflows. However, absorbing of net foreign currency flows into the country has contributed to the rapid growth of rupee liquidity in the domestic market.

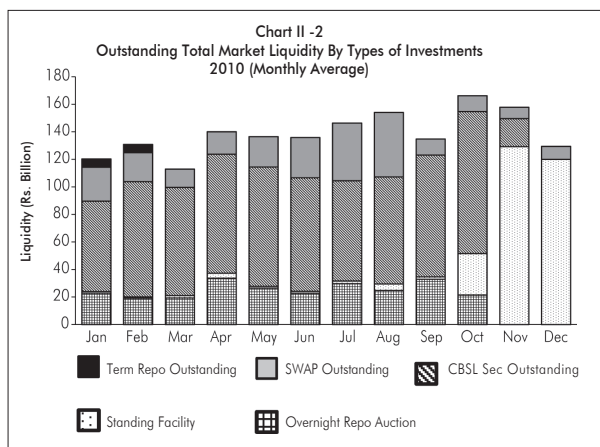
The CBSL relaxed its monetary policy stance further by bringing down the policy rates twice during the year in line with the benign inflation and inflation outlook to support the recovery in the domestic economic activity. In July 2010, both Repurchase (repo) rate and Reverse Repurchase (reverse repo) rate were reduced by 25 basis points to 7.25 per cent and 9.50 per cent

respectively. In August 2010, Reverse Repo rate was further reduced by 50 basis points to 9.00 per cent, narrowing down the policy interest corridor from 225 basis points to 175 basis points. CBSL aggressively engaged in its OMO, facilitating the realization of the monetary targets and maintaining the inter-bank overnight market rates within the corridor (Chart II-1). The SRR of commercial banks was maintained at 7.00 per cent throughout the year.



Liquidity in the domestic banking system was in surplus throughout the year and recorded its peak level in first week of October (Chart II-2). The majority of surplus market liquidity was absorbed temporarily through repo auctions and the standing facility on overnight basis. Further absorption was also continued on a relatively longer term basis through issuing of CBSL securities and foreign exchange swaps (FX swaps) auctions. The permanent absorption through sale of government securities on outright basis was very minimal due to inadequacy of such securities held by the CBSL. In October 2010, Sri Lanka issued its third sovereign bond valuing one billion US dollars (Rs. 112 billion) at the international capital market. Part of these funds was used to settle government liabilities with FCBU's of commercial banks and payment of selected import obligations of the government. The purchase of remaining amount of US dollar 878 million by the CBSL was expected to inject an additional liquidity amounting to Rs. 98 billion to the banking system. In order to deal with the increasing rupee liquidity position, CBSL retired its own stock of government securities valued at Rs. 55 billion thereby, limiting the net increase in market liquidity to only Rs. 43 billion. Consequently, the liquidity surplus recorded its maximum level of Rs. 173 billion in the first week of October.

Domestic money market continued to experience an anomaly in its short-term interest rates irrespective of a numerous efforts by CBSL. The short-term Treasury bill yields continue to trade below that of the overnight repo auction rates on persistent excess short-term funds in the banking system that preferred short-term government securities as an investment alternative. Consequently, CBSL desisted from conducting overnight repo auctions and issue of CBSL securities on term basis through auctions temporally under OMO since 20th October 2010 expecting adjustment of the short-term market interest rates facilitating comparability of interest rates. This strategy facilitated speedy adjustment of the anomaly in the short-term interest rates to a greater extent. Licensed commercial banks and Primary dealers are allowed continuously to place their excess funds under the standing facility on overnight basis at repo rate of 7.25 per cent per annum with CBSL. However, FX-swap auctions continued without any restriction.



The process of liquidity absorption continued with issuing of CBSL securities in the presence of drastically depleted government securities holding of CBSL.

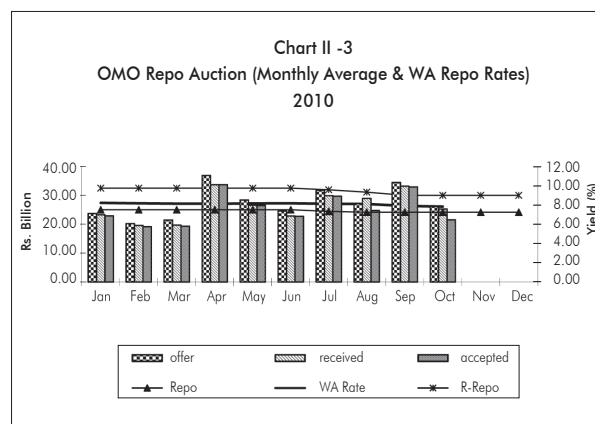
However, the structural issues in the inter-bank market for short-term investments including those confronted by Participating Institutions (PIs) limited the use of CBSL securities for continued liquidity absorption. In addition, high sterilization costs on CBSL balance sheet prompted CBSL to look for alternative measures of liquidity absorption. Consequently, a new scheme named "Government Securities Borrowing Program" was introduced in the fourth quarter of the year. Under this scheme, the CBSL borrows government securities (mainly bonds) from large institutional investors and

use them as collateral for repurchase transactions under OMO. The use of borrowed instruments for repurchase transactions entailed a much lower cost compared to CBSL securities even after inclusion of the borrowing cost. As such, the new arrangement was useful in reducing cost impact of sterilization on CBSL balance sheet. Moreover, the underlying security being government securities, there was no difference on the liquidity preference by the market participants. Moreover, the programme allowed an additional return for the holder of government securities as they were kept otherwise idle until maturity in most instances. CBSL expects that this new arrangement would create an opportunity to develop the domestic bond lending market. The savings attributed to CBSL balance sheet through the new scheme was around Rs. 114 million during 2010.

### 6.1.1 Open Market Operations

#### (a) Overnight Repo Transactions

The liquidity surplus within the banking system was mainly absorbed on a daily basis by conducting auctions to sell Treasury bills, held by the CBSL, on a repurchase basis until 19 October. On average, about Rs. 25 billion per day was offered at the auction and this was around 90 per cent of daily overnight liquidity surplus. The weighted average yield rate of overnight repo auction (Chart II-3) gradually declined from 8.24 per cent from the beginning of the year to 7.68 per cent in the third quarter. Weighted average repo rate moved within the corridor reflecting stable market conditions.





As explained under Section 6.1, CBSL continued to offer government securities as collateral (in repurchase transactions) using government bonds borrowed from the Employees' Provident Fund (EPF) under newly introduced Securities Borrowing Program.

### (b) Outright Transactions

The CBSL conducted outright sale auctions to sell Treasury bills out of its own portfolio, in order to absorb excess liquidity on a permanent basis. Total value of Treasury bills sold through outright sales auction amounted to Rs. 13 billion in 2010. The tenure of the Treasury bills sold ranged from 8 days to 57 days while the yield rates ranged from 7.8 per cent to 8.5 per cent.

#### 6.1.2 Issue of CBSL Securities

Due to inadequacy of government securities in its portfolio to absorb excess market liquidity, CBSL offered securities both on an overnight and term basis to mop up liquidity. On average, the CBSL securities amounting to Rs. 39 billion was offered at the overnight auctions till 19 October and accepted about Rs. 35 billion. Weighted average yield rate (net of tax) varied between 7.8 per cent to 8.3 per cent. In some instances, before introduction of the Bond Borrowing Program, CBSL securities were issued under the standing facility at the repo rate.

The CBSL securities were also issued to absorb excess liquidity on term basis. Tenure of the term auctions varied from 11 days to 32 days in 2010. The weighted average yield rate varied from 7.8 per cent to 8.9 per cent (net of tax).

#### 6.1.3 FX swap Transactions

FX swap auctions (sell-buy) which were introduced by end 2009, as a tool of absorption of excess liquidity, became more popular among market participants in the year of 2010. The total value of swaps used during the year for this purpose, amounted to Rs. 243 billion (US dollars 2,147 million).

#### 6.1.4 Standing Facilities

Standing facilities were provided at CBSL Repurchase rate to Pls who were unable to place their available

funds at the daily auction throughout the year. With the temporarily cessation of auctions under OMO and in the absence of liquidity absorption auctions, Pls placed their total excess liquidity using the standing facility at the Repurchase rate on overnight basis. As a result, the average placements under the standing facility during the first three quarters of the year stood at Rs. 2 billion per day, which was much smaller than the average placements of Rs. 94 billion reported during the last quarter of 2010. Consequently, the repurchase transactions under the standing facility for the year 2010 reported an average of about Rs. 26 billion per day. Repos under the standing facility became the key liquidity absorption instrument during the latter part of the year while FX swaps were significant in the above process.

#### 6.1.5 Statutory Reserve Requirement (SRR)

The SRR is a minimum reserve that each commercial bank must hold in terms of the regulations of the CBSL in the reserve account with the CBSL based on the deposit liabilities of each of such bank. The DOD is responsible for enforcing SRR which stood at 7.0 per cent of rupee deposit liabilities throughout the year 2010.

#### 6.1.6 Bank Rate

The Central Bank's rate of interest (Bank rate) on short-term advances to licensed commercial banks stipulated under Section 87 of the Monetary Law Act, remained unchanged at 15 per cent. However, this rate was only of academic interest during the year as no necessity arose for banks to borrow from CBSL at the Bank rate during the year. Instead, the banking system was flooded with excess liquidity and inter-bank lending rates were substantially low.

### 6.2 Banker to Commercial Banks and the Government

#### 6.2.1 Accounts of Financial Institutions

The DOD provided current account facilities to commercial banks and primary dealers to facilitate inter-bank payments and settlement system as part of Central Bank's role of the banker to commercial banks. As at the end of 2010, CBSL maintained

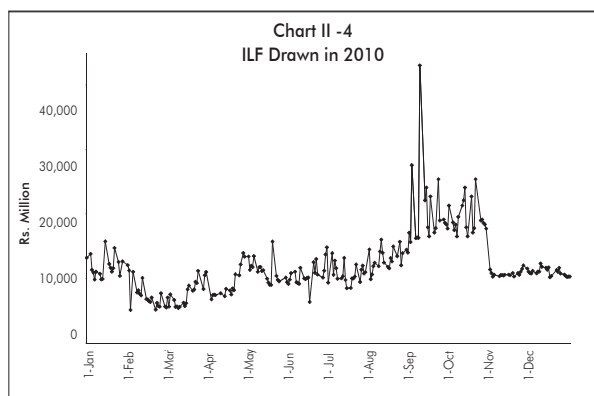
accounts for 22 commercial banks and 8 primary dealers. These accounts were operated on a Real Time Gross Settlement basis within the Automated General Ledger system of the Bank.

### 6.2.2 Government Accounts

The Department also maintained the accounts of government departments, government agencies and institutions and statutory boards to provide them with required banking facilities as part of the function as the banker to the government. Total number of such accounts maintained by CBSL stood at 57 as at end 2010 including three new accounts opened during the year. In terms of section 89 of the Monetary Law Act, CBSL provides provisional advances to the government free of charge, subject to a limit of 10 per cent of the estimated government revenue in any given fiscal year. During 2010, the provisional advances so extended have decreased by 3 billion rupees to Rs. 84 billion from that of the previous year due to the lower government revenue estimated for 2010, compared to that of the previous year.

### 6.3 Provision of Intra Day Liquidity Facility (ILF)

The DOD ensured the smooth and efficient functioning of the RTGS system by providing ILF to Pls. This facility was provided free of charge against the collateral of Treasury bills and bonds, which were valued at their current market prices with a sufficient hair cut to cover any variations in market prices during the day. A significant development in year 2010 was the implementation of a "Participants' Managed ILF System", enabling the Pls to obtain and return ILF funds as and when required.



The total value and average daily value of ILF drawn during the year amounted to Rs. 2,747 billion and Rs. 11 billion respectively. This shows a marginal increase in the ILF utilization over that of the previous year at Rs. 2,725 billion and Rs. 12 billion respectively. Implementing strict measures such as the penal rate of interest over and above the inter-bank rate (at bank rate) and the suspension of the facility for repeated defaults have ensured the prompt reversal of ILF before the close of business of LankaSettle. As a consequence, there were no ILF defaults in any given day during 2010.

## 7. ECONOMIC RESEARCH

The Economic Research Department (ERD) continued to discharge its statutory responsibilities by facilitating the Central Bank's policy decisions towards its core objective of economic and price stability. In accomplishing its responsibilities, ERD continued to provide comprehensive analysis on macroeconomic developments and to recommend policies to the management and to the Monetary Board, while assisting the management in discharging the Central Bank's responsibilities as the economic adviser to the government. In addition, ERD continued to disseminate information on economic and financial developments in the country to the general public through statutory and other publications, press releases and updates on the Central Bank's website. In carrying out these responsibilities, ERD continued its policy oriented economic research, while collecting and compiling macroeconomic data from both domestic and international sources and carrying out comprehensive analyses of macroeconomic developments. During the year, ERD was actively involved in various policy advisory committees set up by the government, while providing economic advice and observations on issues forwarded by various departments in the Bank.

### 7.1 Conducting Research for Assisting Monetary Policy Formulation

With a view to strengthening the existing monetary policy framework in line with the economic developments as well as technological advancements and innovations taking place in the financial system, ERD studied possible improvements to the existing

monetary policy framework. This was particularly relevant in view of the vast structural changes taking place in the economy, which could result in significant changes in financial flows and demand for money. Following the study, it was decided by the Bank to place greater emphasis on analyses of economic and monetary developments (dual analysis) that would have short to medium term implications on the economy, in formulating monetary policy within the monetary targeting framework.

ERD continued to facilitate deliberations of the Monetary Policy Committee (MPC), which makes recommendations on monetary policy for the consideration of the Monetary Board. ERD continued to prepare comprehensive reports of economic and monetary analysis to MPC and to the Monetary Board on a regular basis.

During 2010, ERD improved the survey on commercial bank advances to the private sector, re-classifying credit granted to the private sector with a view to identifying credit flows to different sectors of the economy, which could be useful in the monetary policy decision making process.

Further, in 2010, ERD organised the Third International Research Conference providing an opportunity to discuss recent research findings and share views among researchers from regional central banks and policy makers. As in previous years, officers in ERD engaged in conducting joint research with International Organisations such as the South East Asian Central Banks (SEACEN) Centre. As a knowledge sharing and updating programme in ERD, weekly seminars were conducted by the officers in the department and some other lectures by eminent persons on timely topics were organised to enhance the knowledge of officers in ERD. With a view to fostering research on subjects of contemporary importance, the following research papers were completed in 2010 and are to be published in the Central Bank's Staff Studies:

- (a) "Finance - Growth Nexus: Evidence from Sri Lanka" by Mr. H. Amarathunga
- (b) "Return Volatility and Asymmetric News Effect

in the Sri Lanka Stock Market" by Ms. Sujeetha Jegajeevan

ERD continued to conduct monthly, half-yearly and annual Industrial Production Surveys during 2010 and compiled the Industrial Production Volume Index (IPVI) to evaluate industrial sector performance. During 2010, ERD organised several field visits by its officers to selected industries and discussed how to further improve the Private Sector Industrial Production Survey. Furthermore, ERD officials met with representatives from various industry sectors such as the Joint Apparel Association Forum (JAAF) to obtain a better understanding about the performance and issues in the industrial sector. A survey on housing approvals in the Greater Colombo Area was also conducted in order to prepare a Housing Approvals Index.

ERD co-ordinated meetings with the Monetary Policy Consultative Committee (MPCC), which was established to strengthen the monetary policy decision making process by obtaining views of the private sector. The members of the MPCC in 2010 comprised Prof. A.D.V. de S Indraratne (Chairman), Mr. Sohli Captain, Mr. Yohan Perera, Mr. Mahen Dayanada, Mr. R.M.B. Senanayake, Mr. M.P. Jayawardena, Mr. Cubby Wijetunga and Mr. Amal Cabraal. The MPCC meets on a monthly basis to review macroeconomic developments and make recommendations, thus enhancing the monetary policy decision making process.

## 7.2 Preparation of Statutory and other Reports and Publications

As in previous years, ERD prepared the Annual Report of the Central Bank for 2009, Recent Economic Developments- Highlights of 2010 and Prospects for 2011 and Monthly Bulletins with the support of other departments. ERD also prepared the September 15th Report, a confidential report submitted to the Minister of Finance and Planning under Section 116 (1) of the Monetary Law Act to facilitate the preparation of the government budget. One of the key responsibilities of ERD is to disseminate important economic data and information on different economic sectors to the general public. Fulfilling this requirement, ERD

continued to issue regular press releases on monetary policy, balance of payments and international trade and special press releases whenever necessary to convey important economic information to the public.

For the fourth consecutive year, ERD prepared the "Road Map, Monetary and Financial Sector Policies for 2010 and Beyond", the policy statement of the Central Bank, which was announced to the public on 04 January 2010. The purpose of the Road Map is to enhance the predictability and transparency of the Central Bank's policies which would help stakeholders to design and better calibrate their own plans and strategies for the period ahead. A similar policy statement was prepared for 2011 as well, which was announced on 04 January 2011.

The Department continued to provide independent views on cabinet papers, which have important economic and monetary implications. It also continued to evaluate monetary implications of all foreign loans obtained by the government and made its recommendations to the Monetary Board.

### **7.3 Contribution to Knowledge Enhancement and Sharing of Expertise**

ERD continued to share the expertise of its staff to improve the knowledge on economics, both within and outside the Central Bank. Officials of ERD served as resource persons at the Centre for Banking Studies (CBS) and various outside institutions such as universities, schools, and various other government and private sector institutions. In addition, the officers made presentations on central banking and macroeconomic developments to both local and foreign delegations who visited the Bank. Further, senior officers of ERD assisted postgraduate aspirants of the Central Bank to prepare research proposals and research papers.

Senior officials of the Department served on various committees and boards in the Bank as well as in outside institutions. Representation at outside committees included, committees on National Higher Education Management Information System

(NHEMIS), Management Committee at the Ministry of Higher Education (HMC), Committee of Refurbishment of M7 Class Locomotives, Presidential Task Force on Renewable Energy, Finance Commission Steering Committee on Promoting Provincial Growth for Eliminating Inter-regional Imbalances, Working Group on Policy Advocacy at the National Enterprise Development Authority, National Committee on Socio-economic and Policy Analysis at the Sri Lanka Council for Agricultural Research and Policy, International Labour Organisation Committee on Analysing Labour and Social Trends in Sri Lanka - 2010, Economic Review Advisory Committee (ERAC) of the People's Bank, Steering Committee on Healthcare Financing and Steering Committee on National Health Accounts and the Financial Sector Monitoring Committee at the Treasury. Further, ERD officials served as members of the official committees appointed by the Ministry of State Resources and Enterprise Development to examine and report on Commercially Non-Viable Government Institutions. ERD officials accompanied the Sri Lanka delegation to the Trade Policy Review for Sri Lanka held in Geneva, Switzerland from 4-5 November 2010. In addition, senior officials of ERD represented the Bank at meetings conducted by various Ministries including the Ministry of Finance and Planning.

### **7.4 International Relations**

ERD continued to coordinate with multilateral organisations such as IMF, World Bank, the Asian Development Bank (ADB), SEACEN and South East Asia, New Zealand, Australia (SEANZA), on behalf of the Central Bank and the Government. ERD closely worked with four IMF staff missions that visited Sri Lanka to review the IMF-SBA facility during the year and discharged the responsibility of regular data reporting under the IMF-SBA facility. Also, ERD closely worked with three international sovereign rating agencies namely; Fitch Ratings, S & P Ratings and Moody's Ratings. In addition, two SEACEN courses on Macroeconomic and Monetary Policy Management and Regulations and Supervision of Micro Finance Institutions were organised by the Department in collaboration with the CBS.

## 8. EMPLOYEES' PROVIDENT FUND

The Employees' Provident Fund (EPF) Department continued to perform duties and discharge functions in terms of provisions of the Employees' Provident Fund (EPF) Act No.15 of 1958, during 2010. These include collection of member contributions and surcharges, maintenance of member accounts, investment of surplus funds, payment of benefits to beneficiaries and charging the expenditure incurred by the Monetary Board and Commissioner of Labour in the performance of their duties and functions under the EPF Act to the Fund. In carrying out these functions, EPF Department worked closely and collaborated with the Commissioner of Labour.

### 8.1 Membership, Member Balances and Refunds

Total number of member accounts increased by 3.9 per cent to 13.3 million by end 2010 compared to 12.8 million recorded at the end of 2009. The number of contributing member accounts increased to 2.3 million by end 2010 from 2.1 million as at end 2009 and non-contributing member accounts increased from 10.7 million by end 2009 to 11 million as at end 2010. Meanwhile, the number of contributing employers increased to 62,000 by end 2010 from 61,396 at the end of 2009. These increases were largely contributed by the new registration of employments in the Northern and the Eastern Provinces.

The total value of the Fund stood at Rs. 900 billion by end 2010 compared to that of Rs. 770 billion by end 2009 recording a considerable increase of 16.9 percent. The growth in the contribution made on behalf of the members and the income generated through the prudent management of the Fund enabled to increase the size of the Fund during 2010. As at end 2010, total liability to the members stood at Rs. 869.2 billion recording a 15.5 per cent increase from Rs. 752.5 billion as at end 2009 (Table II-1). These figures include the interest income credited to the member accounts as at end 2009 and 2010. The net contribution (gross contribution less refunds of benefits) also increased to Rs. 20 billion compared to Rs. 17 billion in the previous year. The total amount of refunds to the members and their legal heirs in 2010 was Rs. 34.9 billion, which was an increase of 9.4

per cent over Rs. 31.9 billion in 2009 while the number of refunds decreased by 3.3 per cent over that of the previous year.

**Table II-1**  
**Selected Key Information of the Fund**

Item	2009	2010 (a)	Change (%)
Total number of member accounts (mn)	12.8	13.3	3.9
Contributing member accounts (mn)	2.1	2.3	9.5
Non-contributing member accounts (mn)	10.7	11.0	2.8
Contributing employers	61,396	62,000	1.0
Total contributions (Rs.mn)	48,712	54,796	12.5
Total refunds (Rs. mn)	31,901	34,896	9.4
Number of refunds	108,066	104,528	(3.3)
Total liability to members (Rs.bn)	752.5	869.2	15.5
Total value of the Fund (Rs.bn)	769.7	899.7	16.9

(a) Provisional

Source: EPF Department, Central Bank of Sri Lanka

### 8.2 Investment of Funds and Return

(i) **Investment Portfolio:** As at the end 2010, the total investment portfolio (Book Value) of the Fund grew by 17.5 per cent to Rs. 867.1 billion from Rs. 738.1 billion in 2009 (Table II-2). The investment policy of the Fund continued to focus on providing a long-term positive real rate of return to the members while ensuring the safety of funds and maintaining a sufficient level of liquidity to meet refund payments and other expenses of the Fund. Accordingly, 94.1 per cent of the Fund was invested in government securities while 5 per cent was invested in equity and 0.7 per cent was placed in corporate debentures. The balance 0.2 per cent was invested in high liquid assets such as Reverse – Repos on government securities to maintain liquidity.

**Table II-2**  
**Investment Portfolio**

Type of Investment	2009		2010	
	Rs.bn	Share (%)	Rs.bn	Share (%)
Treasury bonds & bills	659.9	89.4	774.8	89.4
Rupee Loans to Government	56.6	7.7	40.9	4.7
Corporate Debentures	8.3	1.1	6.3	0.7
Equity	9.8	1.3	43.7	5.0
Reverse Repos	3.5	0.5	1.4	0.2
<b>Total</b>	<b>738.1</b>	<b>100.0</b>	<b>867.1</b>	<b>100.0</b>

Source: EPF Department, Central Bank of Sri Lanka

(ii) **Investment Income:** The total income from investment in 2010 increased to Rs. 121.3 billion from Rs. 109.6 billion in 2009 recording a growth rate of 10.6 per cent (Table II-3). As in the past, the interest income including amortization gain was the major source of income (97.5 per cent of the income) to the Fund. Income from these two sources grew by Rs. 11.1 billion to Rs. 118.2 billion in 2010 from Rs. 107.1 billion in 2009. The weighted average rate of return on government securities held by the fund was 13.4 per cent and the yields of those securities varied between 10.6 per cent and 14.5 per cent. The capital gains and dividends realized from the equity portfolio increased four-fold to Rs. 1,664 million in the year 2010 from Rs. 348 million in 2009 mainly due to benefits harnessed through the improvement in the equity market (Table II-3). Overall, the rate of return on total portfolio decreased to 15 per cent in 2010 from 16 per cent in 2009 due to a decline in the interest rates mainly in the government securities market during 2010.

**Table II-3**  
**Income on Investments**

Source of Income	2009		2010	
	Rs.mn	Share (%)	Rs.mn	Share (%)
Interest	79,810	72.9	89,165	73.5
Amortized gain	27,337	24.9	29,061	24.0
Capital gain from Government Securities	594	0.5	874	0.7
Capital gain from Equity	215	0.2	1,054	0.9
Dividends	133	0.1	610	0.5
Market to Market Gain/(loss)	1,346	1.2	106	0.1
Other	182	0.2	386	0.3
<b>Total</b>	<b>109,617</b>	<b>100.0</b>	<b>121,256</b>	<b>100.0</b>

Source: EPF Department, Central Bank of Sri Lanka

**Table II-4**  
**Maturity Profile of Government Securities Portfolio – End of 2010**

Maturity	Amount Rs. mn	Share (%)	Weighted Average Yield (%)
Less than 1 year	193,810	22.5	14.5
1-2 years	374,991	43.5	14.4
3-4 years	197,615	22.9	10.6
More than 4 years	94,925	11.1	12.2
<b>Total</b>	<b>861,341</b>	<b>100.0</b>	<b>13.4</b>

Source: EPF Department, Central Bank of Sri Lanka

(iii) **Expenses:** Total operational expenditure of the Fund increased by 8 per cent to Rs. 824 million in 2010 from Rs. 763.1 million in 2009 (Table II-5). The Fund managed to maintain its total operational expenditure at 0.68 per cent of its total gross income in 2010. Maintaining operational expenditure below 1 per cent of the gross income has been a key feature of the Fund over the years.

**Table II-5**  
**Operational Expenditure**

Item	2009	2010	Change (%)
	Rs.mn	Rs.mn	
Personnel Expenses	370.2	414.3	11.9
Administrative Expenses	357.0	368.1	3.1
Other Expenses	35.9	41.6	15.9
<b>Total</b>	<b>763.1</b>	<b>824.0</b>	<b>8.0</b>
<b>Total Expenses as a % of Gross Revenue</b>	<b>0.70</b>	<b>0.68</b>	<b>(0.02)</b>

Source: EPF Department, Central Bank of Sri Lanka

### 8.3 Payment of Interest on Member Balances

In 2010, a sum of Rs. 96,562 million was available for distribution as interest to the members of the Fund (Table II-6). Accordingly, the Fund was able to pay interest at the rate of 12.5 per cent on member balances which is considerably a higher rate of return compared to the current interest rate structure in the economy.

**Table II-6**  
**Payment of Interest to Members**

Item	2009	2010	Change (%)
	Rs. mn	Rs. mn	
Gross Revenue	109,617	121,256	10.6
Total operating expenses	763	824	8.0
Income tax	7,604	8,987	18.2
Net income available for distribution	101,690	111,463	9.6
Interest paid on current refunds	1,656	1,901	14.8
Net income available for distribution (after payment of interest on current refunds)	100,034	109,562	9.5
Transfers from /(to) reserves	(9,325)	(13,000)	39.4
Net income available for distribution after transferring from / (to) reserves	90,709	96,562	6.5
Interest paid on member balances	90,691	96,268	6.1
Carried forward balance	18	294	1,533.3
Interest rate paid on member balances %	13.75	12.50	(1.25)

Source: EPF Department, Central Bank of Sri Lanka

$EIR^1 = \frac{\text{Interest paid to Members}}{[(\text{Beginning of the year member balances} + \text{year end member balances})/2]}$

**Table II-7**  
**Interest Rate Paid on Member Balances**

Year	Interest Rate Paid (%)	Effective Interest Rate (%) <sup>1</sup>
2000	11.50	11.69
2001	11.50	11.69
2002	12.10	12.26
2003	12.00	12.07
2004	9.50	9.59
2005	9.00	9.13
2006	10.10	10.30
2007	11.20	11.40
2008	13.20	13.44
2009	13.75	13.92
2010 (a)	12.50	12.65

(a) Provisional

Source: EPF Department, Central Bank of Sri Lanka

### 8.4 Member Account Statements

The member account statements for the first half of 2010 were issued to members through their employers during December 2010. Arrangements have been made to issue account statements for the second half of 2010 by end of June 2011.

### 8.5 Housing Loan Facility

The Housing Loan Scheme which was introduced in 1998 with the objective of facilitating the members to obtain housing loans from the six participating lending institutions, viz., Bank of Ceylon, People's Bank, State Mortgage and Investment Bank, HDFC Bank, Co-operative Rural Banks and National Housing Development Authority continued in 2010. EPF continued to issue certificates of guarantees to members as against their EPF balances under this scheme. During the year, 13,848 member balance certificates were issued to participating lending institutions for the approval of housing loans amounting to Rs. 4,512 million (Table II-8). Further, nearly Rs. 2,093 million was deducted from relevant member accounts and was remitted to the participating lending institutions to settle the loans in arrears during 2010.

**Table II-8**  
**Housing Loan Facility**

Year	Number of Certificates Issued	Credit Approved Rs.mn	Amount Remitted to Lending Institutions Rs.mn
2000	12,938	1,648	262
2001	16,066	2,091	381
2002	19,502	2,673	541
2003	18,689	2,792	670
2004	14,307	2,452	735
2005	14,600	2,766	900
2006	15,136	3,049	1,078
2007	12,969	2,872	1,240
2008	12,519	3,008	1,192
2009	10,383	2,680	1,552
2010 (a)	13,848	4,512	2,093
<b>Total</b>	<b>160,957</b>	<b>30,543</b>	<b>10,644</b>

(a) Provisional

Source: EPF Department, Central Bank of Sri Lanka

### 8.6 Public Awareness

EPF Department in collaboration with the Department of Labour held two mobile services in Jaffna District and one mobile service in Maskeliya, Batticaloa, and Vavuniya each to address the problems faced by members of the Fund residing in the respective areas. EPF Department participated at two public exhibitions "Deyata Kirula" and "HR Service Providers' Exhibition" in 2010. In the International HR Conference & HR Service Providers exhibition organized by Institute of Personnel Management (IPM), EPF Department won the Most Informative Stall Award in 2010. Further, first time in its history, EPF Department organised a full day workshop for all district-level labour officers and the relevant officers of the Central Bank in 2010 and this was attended by more than 150 officials representing all districts in the island.

### 8.7 System Development

With the objective of converging the existing system to an automated banking model in the medium-term to enhance efficiency and effectiveness of services to EPF members and the employers, EPF Department with the support of the IT Department took several initiatives

to overhaul its IT systems in 2010. Primarily a new ledger system was introduced in mid-2010 and live operations commenced from 01st January 2011. The new ledger system records all transactions centrally, while facilitating greater integration of processes in the EPF system at the Central Bank, leading to operational efficiencies and greater accuracy of data, due to reduced manual interventions. Moreover, the new system supports identification of members by the National Identity Card (NIC) number.

### 8.8 Re-registration of Members

To facilitate the smooth functioning of the newly developed IT system in its full capacity, it was essential to develop a Member Centric Database (MCD) assigning a unique identification number to each member. The Re-registration of EPF members is one of the key projects launched jointly by EPF Department and Department of Labour to re-register EPF members by names as appearing in their NICs and assign NIC number as the unique number to identify a member in the EPF system. A salient feature of development of this database is that it will enable both institutions to use a common database for maintenance of EPF member accounts.

Under this project, NIC information of around 800,000 active members was collected by end 2010 and unique identification numbers were assigned for 77 per cent of those members. A new member registry (common database for CBSL and DL) was created with the member information that was collected.

A new data collection mechanism was also implemented for active members, who have not provided their NIC details under the project. At the same time, a real-time registration process for new EPF members who would be joining after 01st November 2010 was implemented. Accordingly, all employers have to provide the NIC information of all new employees recruited after 01st November 2010 to their establishments together with the initial member contribution details to EPF Department.

Further, previous employment numbers of active members who have furnished information under this project, will also be linked to their NIC numbers with the



objective of enabling them to review their all multiple member accounts under the unique identification number. Re-registration of all EPF members, is the ultimate objective of the project, where the data collection of members who are not contributing at present is scheduled to begin in 2011.

### 8.9 EPF Contributions through Electronic Media

EPF Department launched a special project for collection of member contribution (C and C3 returns) through electronic media (E>Returns) instead of receiving paper documents which involve manual processes. Employers who wish to send their member details through E-returns were invited to join this scheme. The E-returns which is a total paperless solution for employers to send the EPF returns minimizes the problems currently faced by EPF Department with the traditional manual EPF return system. The employers who send E-returns can also join the Direct Debit Payment Scheme which enables employers to make monthly payments through a standing order on employer bank account to transfer the funds to EPF on a specified date monthly.

Further, EPF launched a special awareness campaign to promote E-returns during 2010. Accordingly 13 awareness programmes were conducted during the year with the purpose of promoting E-returns among employers. As a result, the number of employers having joined the E-return scheme has been increased to 888 by end 2010 from 585 employers at end 2009. These employers covered more than 18 per cent of the total contributions received by EPF Department in 2010. Number of employers who participated in Direct Debit System too increased from 202 in 2009 to 246 in 2010 and they covered 2.5 per cent of the total member collection of 2010.

### 8.10 The Image Scanning Project

A feasibility study for developing an electronic record management system i.e. Image Scanning Project was completed in 2010. The Image Scanning Project which will commence in 2011 will enable EPF Department to maintain all member information in electronic form. Under this scheme, all master files of members will be scanned and archived in electronic form. This will reduce the cost of storing, handling and securing

printed information and the time consumed for retrieving the files.

## 9. EXCHANGE CONTROL

The Exchange Control Department (ECD) carries out the exchange control function of the Central Bank of Sri Lanka (CBSL) as the agent of the government by administering the provisions of the Exchange Control Act No. 24 of 1953 as amended. In discharging the duties of the ECD during the year, it followed a strategic mechanism to achieve its goals announced in the Road Map, 2010. ECD considered the conducive economic environment of the country in particular in designing its activities.

The improved macroeconomic conditions, particularly, the reduction in inflation, improving fiscal performance, increasing foreign reserves and decline in interest rates and political stability created a favourable environment in the economy to relax exchange controls of the country further. Accordingly, CBSL took steps to open the capital account further and removed some barriers imposed on current account transactions in 2010. Meanwhile, CBSL introduced several new foreign currency accounts for market participants in order to facilitate this liberalization process. These measures would help to achieve higher economic growth in the country and enhance international investors' confidence.

In addition, ECD continued its ongoing activities during the year 2010 including issuance of Directions / Operating Instructions to authorized dealers and others dealing in foreign exchange, granting approvals for foreign exchange transactions, surveillance on various foreign exchange transactions and investigations into violations of the provisions of the Exchange Control Act.

### 9.1 Relaxation of Capital Account Transactions

#### (a) Permission for transfer of Rupee Denominated Debentures issued by the Urban Development Authority (Gazette No. 1673/43 dated 01st October, 2010):

The Controller of Exchange granted permission by order made under sections 7,10 and 11 of the Exchange Control Act (Chapter 423), to the Urban

Development Authority (UDA) to issue Rupee Denominated Debentures to foreign institutional investors, corporate bodies incorporated outside Sri Lanka, individuals resident outside Sri Lanka and Sri Lankans resident outside Sri Lanka enabling UDA to mobilize funds for their development activities.

**(b) Permission to foreigners to invest in Rupee Denominated Debentures issued by local companies (Gazette No. 1681/11 dated 22nd November, 2010):**

Considering the advantages of a developed bond market and with a view to broadening the investor base and improving liquidity in the secondary market, it was decided to allow foreigners to invest in Rupee Denominated Debentures. Such participation is also likely to contribute to a sustained and gradual reduction of interest rates in the domestic market.

Accordingly, the Controller of Exchange granted permission by order made under sections 10, 11, 15 and 30(5) of the Exchange Control Act (Chapter 423), to foreign institutional investors, corporate bodies incorporated outside Sri Lanka, individuals resident outside Sri Lanka and Sri Lankans resident outside Sri Lanka to issue and transfer of convertible or non-convertible, redeemable or non-redeemable debentures denominated in Sri Lankan Rupees in a company classified as a specified business enterprise in terms of the Sri Lanka Accounting and Auditing Standards Act, No. 15 of 1995.

**(c) Expedition of approvals for companies to borrow from foreign sources:**

Sri Lanka needs to enhance inflows of foreign investments to maintain its expected high growth momentum, and it is therefore, necessary to create alternative avenues to meet financing needs of the entities at a relatively low cost. Accordingly, permission was granted to companies that are engaged in a variety of businesses irrespective of the fact that such business entities are foreign exchange earners.

This measure would ease the pressure for funds in the local market and enhance the opportunities available to expand domestic economic activities.

**(d) Permission for foreign companies to open places of business in Sri Lanka (Gazette No. 1681/10 dated 22nd November, 2010):**

Many foreign companies have shown a keen interest to establish places of business in Sri Lanka. At the same time, the Companies Act requires that the establishment of a place of business in Sri Lanka by overseas companies should be in accordance with the regulations made under the Exchange Control Act. However, a clear and convenient mechanism was not in place for such companies to bring in the funds necessary for the establishment and maintenance of such business as well as for the regulation of the repatriation of surplus funds and other outward payments.

Accordingly, permission was granted by order made under sections 29C and 30(5) read with section 48 of the Exchange Control Act to companies incorporated outside Sri Lanka and registered as an "overseas company" under the Companies Act No. 7 of 2007, to carry on business in Sri Lanka, so as to further facilitate foreign direct investment into the country.

**9.2 Removing Barriers on Current Account Transactions**

**(a) Permission for opening and maintaining accounts with banks outside Sri Lanka (Gazette No. 1644/26 dated 11th March, 2010):**

General permission was granted under section 6AA and sub – section (1) of section 8 read with Section 48 of the Exchange Control Act, to persons in or resident in Sri Lanka and companies or firms registered in Sri Lanka to open and maintain and operate foreign currency accounts with any bank outside Sri Lanka or close such accounts.

**(b) Expanded permission for forward contracts in foreign currency:**

In order to facilitate the businesses engaged in import and export activities and to hedge

their exposure to exchange risks, in respect of transactions of foreign exchange, existing restrictions on the forward contracts in foreign currency was removed.

**(c) Special Foreign Investment Deposit Accounts (SFIDA):**

Permission was granted to transfer funds between Special Foreign Investment Deposit Accounts (SFIDA) of a non-resident and accounts maintained in Off-Shore Units in Sri Lanka by such non-resident.

**(d) Margin Requirements for Imports made on Advance Payment Terms:**

The 100 per cent margin requirement on invoiced value of imports of selected consumer items was removed after considering the improved external reserve position of the country.

**(e) Issuance of Foreign Currency Notes to Sri Lankans travelling abroad:**

The issuance of foreign currency notes as a part of the travel allowance for Sri Lankans travelling abroad was increased to US\$ 2,500 or its equivalent in other designated foreign currency from the level of US\$ 2,000.

**(f) Permission in terms of sections 7, 10, 11, 15 and 30(5) of the Exchange Control Act (Gazette No. 1685/2 dated 21st December, 2010):**

The notice under the Exchange Control Act published in the Government Gazette (Extraordinary) No. 1232/14 of 19th April 2002, was further amended by inserting "Provision of security services including security management, assessment and consulting to individuals or private organizations" immediately after the item (iv) under exclusions and substituting the words "Securities Investment Account" for the words "Share Investment External Rupee Account".

### 9.3 Introduction of New Accounts

**(a) Securities Investment Account (SIA):**

Introduction of Securities Investment Account

(SIA), amalgamating Share Investment External Rupee Account (SIERA), Treasury bond Investment External Rupee Account (TIERA), Treasury bill Investment External Rupee Account (TIERA 2) and Treasury bonds / bills External Rupee Account – Deshabhimani (TIERA - D) in order to remove the complexity in selecting the means of investments by prospective investors.

**(b) Foreign Currency Accounts for International Service Providers and their Employees (FCAISPE):**

Permission was granted to Authorized Dealers to open and maintain foreign currency accounts for international service providers and their employees to motivate local entrepreneurs, to provide their services to foreign parties and to retain their earnings in foreign currencies enjoying tax concessions.

**(c) Inward Investment Account (IIA):**

Permission was granted to Authorized Dealers to open and maintain an Inward Investment Account (IIA) for Overseas Company for its business operations in Sri Lanka as permission was granted to overseas companies registered under Companies Act No. 7 of 2007 to carry on business in Sri Lanka through a place of business, by Gazette No. 1681/10 dated November 22, 2010.

**(d) Permission to foreigners on tour or business in Sri Lanka to open accounts in foreign currency:**

The tourism sector is expected to expand significantly with the increase in tourist arrivals. It is also likely that the number of non-resident non-nationals who will be on business visits to Sri Lanka would increase substantially. Previously, facilities had not been granted for non-nationals, either on temporary visit to Sri Lanka or intending to visit Sri Lanka, to operate bank accounts and that had caused them considerable inconvenience.

Therefore, it was considered appropriate for non-resident non-nationals who are residing in Sri Lanka or intending to visit Sri Lanka, to be allowed

to open and maintain foreign currency accounts. These foreign currency accounts would facilitate the aforesaid category of non-residents to execute their transactions smoothly and safely during their stay in Sri Lanka and help contribute to expand tourism and business activities in the country.

Accordingly, Permission was granted to Authorized Dealers to open and maintain foreign currency accounts for non-resident non-nationals either on temporary visit to Sri Lanka or intending to visit Sri Lanka.

**(e) Permission to importers of gems and jewelry to open accounts in foreign currency:**

Sri Lanka has been a popular centre for manufacturing, trading and retailing of gem and jewelry. The expected increase in tourist arrivals would also boost expand the demand for gem and jewelry.

Permission was granted to exporters of gem and jewelry to open and maintain foreign currency accounts with a view to facilitate their foreign exchange requirements and to encourage the gem and jewelry industry in Sri Lanka in 2008. Since the importation of gems is mainly undertaken by making the payments in foreign currency, it was decided to extend this facility to indirect exporters and to importers of gem and jewelry as well. Gem and jewelry dealers import gems and increase value addition by cutting, polishing and making jewelry. These foreign currency accounts would facilitate the aforesaid category of importers to undertake their transactions smoothly and help contribute to the growth of the industry.

Accordingly, permission was granted to Authorized Dealers to open and maintain "Foreign Currency Accounts for Gem and Jewelry Dealers" for individuals, firms and companies engaged in the export of gem and/or jewelry, import of gem and/or jewelry, and supply of finished or unfinished gem and/or jewelry to exporters.

**(f) Permission for certain banking transactions in foreign currency and Sri Lanka Rupees to**

**Diplomatic Missions, their staff and family members in Sri Lanka:**

Sri Lanka has enjoyed cordial bilateral and multilateral relationships with foreign nations and these relationships are expanding further in the present economic scenario. At present, foreign diplomatic missions which includes embassies, high commissions, consulates, permanent mission of the United Nations or EU delegation of the European Commission and their staff are considered as non-residents for the purpose of exchange controls and they require specific approvals to engage in certain banking transactions in foreign currency.

Accordingly, permission was granted to Authorized Dealers to open and maintain Diplomatic Foreign Currency Account (DFA) and Diplomatic Rupee Account (DRA) for foreign diplomatic missions, diplomatic personnel and their family members in Sri Lanka.

**9.4 Approval for Investment Abroad and Foreign Borrowing**

ECD processed 76 requests for approval of investments abroad and borrowings from abroad and granted approvals for 30 requests as indicated below in terms of the relevant provisions of the Exchange Control Act.

- (a) Approvals for 18 resident companies to invest abroad amounting to US\$ 38.55 million, mainly in the areas of investment banking, trading, freight forwarding, retail operations and employee share option schemes;
- (b) Approvals for 12 resident companies to borrow from abroad a total sum of approximately US\$ 67.21 million.

**9.5 Issuance of Permits / Licenses to Freight Forwarders, Money Changers and Restricted Dealers:**

ECD continued to issue permits to freight forwarders, money changers and other restricted dealers as indicated below:

- (a) Forty new companies were registered as freight forwarders, bringing the total number of freight forwarders to 341 at the end of 2010;
- (b) Eight new money changer licences were issued bringing the total number of money changers to 83. Further, 11 money changers who were successful in purchasing foreign currency over US dollars 4 million per annum were permitted to sell foreign currency. The required minimum annual turnover for the renewal of a money changing permit has been increased from US dollars 600,000 to US dollars 1 million with effect from 01 January 2010.
- (c) Forty two new permits were issued to other restricted dealers, such as duty free shops, tourist hotels, tourist restaurants, travel agents and gem and jewelry shops and 03 permits were withdrawn bringing the total number of such restricted dealers to 786.

### 9.6 Investigations into Violations of the Provisions of the Exchange Control Act

In order to ensure orderly function of the market participants in foreign exchange transactions and improve efficiency of the foreign exchange market, investigations were conducted into the non-compliance with the directions issued under the Exchange Control Act and contravention of the provisions of the said Act by the dealers in foreign exchange and various other parties.

Accordingly, during the year 2010, 59 Show Cause Letters, 28 Penalty Letters, 27 Direction Letters and 28 Warning Letters were issued and 114 investigations were concluded while Rs. 8,942,555.37 was collected as penalties imposed on the offenders. Most of such investigations were linked to unauthorized acceptance and purchases of foreign currency, issuing securities to non-residents in contravention of the procedure laid down in the general permission granted under the Exchange Control Act and unauthorized payment of foreign currency to non-residents by persons resident in Sri Lanka. Further, 675 numbers of public inquiries and clarifications were attended by the Investigation Division of the ECD during the year 2010.

### 9.7 Other Activities

In continuation of efforts to promote worker remittances through the banking channels, a programme was conducted for Authorized Dealers to induce them to formulate more convenient, efficient and less expensive mechanism for this purpose. A press conference was conducted to announce the further liberalization of Exchange Control regulations. Further, Authorized Dealers were also informed on these liberalized measures by conducting a meeting for them. Officers of the ECD conducted lectures at a number of training programmes and seminars on Exchange Control related issues.

### 10. FINANCIAL INTELLIGENCE UNIT

The Financial Intelligence Unit (FIU) was established in 2006 in terms of the statutory provisions of the Financial Transactions Reporting Act (FTRA), No. 6 of 2006 and its administration was vested with the Monetary Board in 2007. The main functions of the FIU include collection and receipt of information on financial transactions for the purpose of detecting possible links to Money Laundering (ML), Terrorist Financing (TF) and other unlawful activities defined in the FTRA, conduct of investigations into suspicious financial transactions, dissemination of information and details of investigations to relevant regulatory and law enforcement authorities to institute appropriate legal/enforcement actions and issue of directives/regulations on Know-Your-Customer and Customer-Due-Diligence (KYC/CDD) procedures. The highlights of main operations of the FIU during 2010 are as follows.

#### 10.1 Collection of Information and Investigations

In terms of the requirements imposed by the FIU, Licensed Commercial Banks (LCBs), Licensed Specialised Banks (LSBs), Registered Finance Companies (RFCs), Stock Brokering Firms (SBs) and Insurance Companies (ICs) continued to report to the FIU cash transactions and electronic funds transfers (both inward and outward) of Rs. 1.0 million and above or its equivalent in foreign currencies through the FIU's on-line database management system, viz, "LankaFIN" designed to receive and analyse information/data reported by

the institutions. Accordingly, over 3 million of cash and fund transfers and 246 suspicious transaction reports were received during the year. After conducting preliminary investigations, 33 suspicious transaction reports were referred to the law enforcement agencies and regulatory authorities for further investigation. Based on the investigations conducted by Criminal Investigations Department (CID), the Attorney General's Department has filed two indictments against money laundering offences and three indictments against the terrorist financing offences as at 31.12.2010.

### 10.2 Improvement in the Regulatory Framework

With the view to further strengthening the regulatory framework in line with the changes in international standards and best practices on Anti-Money Laundering (AML) and Countering the Financing of Terrorism (CFT), the FIU with the other stakeholders have proposed several amendments to the Financial Transactions Reporting Act, No. 6 of 2006, Convention on the Suppression of Terrorist Financing, Act No. 25 of 2005 and Prevention of Money Laundering Act, No. 5 of 2006. These amendments are aimed at improving the legal and regulatory system to combat ML and TF more effectively, keeping with the standards prescribed by the Financial Action Task Force (FATF), the global AML/CFT standard setter. The FIU is in the process of finalizing these amendments and formulating new rules/directions.

### 10.3 Other Activities

#### i. Signing of Memorandums of Understanding

As a mechanism to facilitate sharing of information for the purpose of investigation and prosecution of suspicious transactions, the FIU signed six Memorandums of Understanding (MOUs) with the Financial Information Processing Unit of Belgium, the Australian Transaction Reports and Analysis Center (AUSTRAC), the Financial Intelligence Units of Bangladesh, India, Solomon Island and the Department of Sri Lanka Customs in 2010. Accordingly, the total number of MOUs signed increased to 12 as at end of 2010.

#### ii. Institutional Capacity Building and Awareness Programmes

In continuation of efforts to enhance the awareness on detecting, analyzing and reporting of money laundering and terrorist financing transactions, 15 awareness programmes were conducted in the Western and Central provinces during the year, accommodating more than 1,100 participants representing LCBs, LSBs, RFCs, Police Department, educational institutions and the general public. Five such programmes were conducted with the assistance from the AUSTRAC, the Australian FIU. Further, the FIU conducted a special programme for judges in collaboration with Sri Lanka Judges' Institute (SLJI) and 61 judges participated in the programme.

#### iii. International Relations

- a). Egmont Group : The FIU obtained assistance from members of the Egmont Group (Association of the FIUs with 118 members) in 12 instances to carry out investigations. Similarly, Sri Lanka FIU also accepted nine requests to facilitate the member countries in gathering evidence to support their on-going investigations.
- b). Asia Pacific Group on Money Laundering: Sri Lanka, as a founder member country of Asia Pacific Group on Money Laundering (APG), attended its 13th Annual Meeting held in Singapore in July 2010. Further, the FIU attended the 13th Annual Typologies Workshop held in Bangladesh focusing on vulnerabilities in the Non-Profit Organizations (NPOs) sector and human trafficking.

#### iv. Conducting of On-site Examination

During the year 2010, the FIU conducted three on-site examinations of reporting institutions to assess reporting institutions' exposure to risk of ML and TF, non-compliance with the provision of FTRA and other rules and directions issued by the FIU. Further, sanctions were imposed on one financial institution where material deficiencies in the compliance were found.

## 11. FINANCIAL SYSTEM STABILITY

The Financial System Stability Department (FSSD) was established in 2007 to assist the CBSL in maintaining the financial system stability, which is one of the core objectives of the CBSL. The main functions of the FSSD include conduct of macro-prudential surveillance, the production of the annual Financial System Stability Review (FSSR) and facilitation of the meetings and functioning of the Financial System Stability Committee (FSSC) and the Financial System Stability Consultative Committee (FSSCC). A brief description of the main activities undertaken by the FSSD in 2010 is given below.

### 11.1 Macro-prudential Surveillance

The FSSD conducts macro-prudential surveillance to identify systemic risks to the financial sector and to assess its capacity to withstand such threats. This involves the analysis of macroeconomic and financial market developments and the risk exposures of banking and other financial institutions. A comprehensive set of aggregate Financial Soundness Indicators is compiled on a periodic basis to monitor the health of key financial institutions. The FSSD prepared regular Financial Sector Assessment Reports for internal purposes. Work has also been initiated to develop a database on corporate sector borrowers to assess its financial strength and debt repayment capacity. The FSSD also contributed towards the development of an early warning system covering the key financial markets and sectors, to alert the CBSL on developments that could trigger an adverse impact on the financial system.

### 11.2 Publications

The FSSR 2009 was published in January 2010. The FSSR 2010 was prepared in the last quarter of 2010 and will be published in the first quarter of 2011. The FSSR 2010 contains six chapters and five box articles which includes an overall assessment of financial system stability and risk mitigation measures, global and domestic macroeconomic developments, performance of domestic financial markets, the banking sector performance and risks, developments and risks of other financial institutions and the

functioning of main payment and settlements systems and regulatory framework governing the financial sector. The FSSD also coordinated the preparation of the chapter on Financial Sector Developments and Stability in the Annual Report 2009 and the Recent Economic Developments 2010.

### 11.3 Coordination of the Committees on Financial System Stability

FSSD continued to serve as the secretariat for the FSSC and FSSCC in 2010.

#### (a) Financial System Stability Committee

The Financial System Stability Committee (FSSC) is chaired by the Deputy Governor in charge of financial system stability. The FSSC was reconstituted in 2010 and consists of eighteen members, including the Deputy Governor in charge of price stability, the Assistant Governors for financial system stability, price stability and payment and settlements and the heads of department of financial system stability, bank supervision, supervision of non-bank financial institutions, payment and settlements, economic research, public debt, international operations, domestic operations, information technology, statistics, exchange control and financial intelligence. The FSSC is an inter-departmental forum for the identification of risks affecting the financial sector, discussion of measures to mitigate risks and the co-ordination of efforts to promote financial system stability. The FSSC met seven times during 2010.

#### (b) Financial System Stability Consultative Committee

The Financial System Stability Consultative Committee (FSSCC) appointed by the Monetary Board in 2008 consists of persons primarily from the private sector to provide views and advice to the Central Bank on financial sector issues. The current FSSCC comprises ten members and met eleven times during the year. The FSSCC made recommendations relating to credit card guidelines, regulation of finance companies, taxation of financial instruments, combating

internet fraud, financial concessions for senior citizens, reinvestment of bank deposits in rural areas, development of life insurance products, unit trusts and money market funds and the stock market.

## 12. GOVERNOR'S SECRETARIAT

The Governor's Secretariat Department (GSD) continued to provide extensive operational assistance required by the Governor, by attending to secretarial work, protocol services, follow up on work assigned by the Governor and facilitating for investor promotion activities.

The GSD, among other things, was responsible for managing appointments of the Governor and related correspondence. During the year under review, the Governor had a large number of meetings with visitors i.e. Hon. Ministers, Hon. Members of Parliament, Ambassadors, Chief Executive Officers of banks and other financial institutions, media institutions, business leaders, and delegations from international financial institutions such as IMF, World Bank and other foreign delegations. All such appointments, correspondence regarding the meetings, follow-up work were well coordinated with relevant parties thereby assuring smooth running of the Governor's schedules.

The GSD provided necessary protocol services for the Governor, visitors of the Governor, and important invitees to the Bank. All arrangements for local and foreign travel of the Governor were also made by the GSD. Accordingly, the Governor made several field visits to a number of places of economic significance in all parts of the country. In addition, the Governor visited the Northern and Eastern provinces, in particular, in order to inspect the new development projects and for branch openings of banks and other financial institutions and to meet with the public, business community and government officials. In this regard, necessary travel arrangements together with protocol services for the Governor for such visits were made by the GSD. Governor has attended a number of symposiums held in Sri Lanka either as the Chief Guest or Keynote Speaker. The Governor made a number

of official visits abroad to attend IMF and World Bank meetings, investor meetings and other high-level international symposiums either as the Chief Guest or Keynote Speaker. While providing all the logistics for the Governor's foreign travel, the GSD facilitated the Governor by compiling necessary information, reports and PowerPoint presentations in order to ensure success of foreign visits. The GSD ensured to provide real time data on operations of money and foreign exchange market and other timely important information to the Governor while he was away from office on official duty. In addition, all official functions hosted by the Governor and Deputy Governors were also arranged by the GSD.

The GSD provided necessary inputs which were requested by Governor for a number of committee meetings of the Bank. In addition, the Governor's work also was facilitated by the GSD in the preparation and presentation of the Strategic Plan 2011 – 2015 of CBSL. The Governor represented meetings outside CBSL for which the GSD provided the necessary data and information required by the Governor. Moreover, during the year, the GSD had regular interactions with foreign investors and provided them with timely information and clarifications on the Sri Lankan economy.

During the year, the Governor attended a number of press conferences and local and foreign media interviews for which the GSD provided necessary logistical arrangements to make such events successful.

The GSD closely followed up the instructions issued by the Governor to other departments and ensured that they are carried out. In addition, the GSD assisted the public by responding to their queries directed to the Governor, with regard to the activities of the Banks and issues relating to the economy of Sri Lanka. As a whole, during the year, the GSD assured efficient support services to the Governor ensuring smooth functioning of the Governor's work.



### 13. HUMAN RESOURCES MANAGEMENT

The focus of the Human Resources Department (HRD) in 2010 as in the past was directed towards reinforcing human capital in CBSL through acquisition of new skills and knowledge, provision of required training for strengthening and deepening the professional and technical talent pool and improving employee engagement in achieving the core objectives of CBSL. The key functions carried out by the HRD in

2010 in this regard included recruitment, demand driven training, capacity building, changing the mind-set of staff to achieve higher productivity, staff promotions, performance management, job rotation, succession planning and motivation. Subsequent to the new recruitments in 2010, the total staff strength in the Bank increased by 19 per cent to 1,497 compared to the staff strength of 1,263 in 2009. The attrition rate due to the retirements and resignations in 2010 was 1.9 per cent compared to 3.6 per cent in 2009.

**Table II – 9**  
**Human Resources Structure as at 31.12.2010**

Categories of Employees	No. of Employees			Average Age (Years)	Educational/Professional Qualifications					
	Male	Female	Total		Post Graduate, First Degree & Professional Qualifications	Post Graduate & First Degree	Post Graduate & Professional Qualifications	First Degree & Professional Qualifications	First Degree	Professional Qualification
(1) Staff Class										
(i) Grade IV and above	51	17	68	52	13	45	02	04	04	0
(ii) Grade III	69	19	88	52	08	40	01	03	36	0
(iii) Grade II	92	88	180	44	06	26	03	29	87	08
(iv) Grade I	85	137	222	45	0	12	01	06	109	0
(v) MTT	38	58	96	27	0	05	01	37	37	16
(2) Non-Staff Class										
(i) Grade V	26	46	72	55	0	0	0	0	19	01
(ii) Grade IV	77	52	129	50	0	0	0	0	09	01
(iii) Grade III	71	14	85	50	0	0	01	0	01	03
(iv) Grade II	108	82	190	33	0	0	0	0	06	03
(v) Grade I	95	02	97	45	0	0	0	0	0	0
(vi) BAA	40	53	93	23	0	0	0	0	11	02
(3) Minor Employee Class										
(i) Grade I, II and III	155	14	169	31	0	0	0	0	0	0
(4) Contractual Employees										
(i) All Categories	04	04	08	45	01	01	01	0	0	0
<b>Total</b>	<b>911</b>	<b>586</b>	<b>1497</b>	<b>41</b>	<b>28</b>	<b>129</b>	<b>10</b>	<b>79</b>	<b>319</b>	<b>34</b>

### 13.1 Human Resources Structure

With the recruitment of 265 employees to the Bank in 2010, the total staff strength as at end of December 2010 stood at 1,497 consisting of 654 staff class officers, 666 non-staff class officers, 169 minor employees and 08 contractual employees. Accordingly, the average age of an employee was reduced to 41 years as at the end of December 2010 compared to 45 years in 2009. As indicated in Table II – 9, nearly 80 per cent of employees in the staff class category had a first degree, a postgraduate degree or a professional qualification. In 2010, 9 employees resigned, while 20 employees retired from the Bank service.

### 13.2 Recruitment

Under the general recruitment policy of the Bank, the HRD took measures to recruit 96 Management Trainees in June and September 2010, respectively, to fill the identified competency gaps in the Bank. In addition, 71 Minor Employees and 94 Banking Assistants were also recruited in June and September 2010 respectively. Considering the necessity for specialised professional services for the Corporate Support Services in the Bank, an Electrical Engineer, a Civil Engineer, an Assistant Comptroller of Security and a Senior Assistant Comptroller of Security were recruited in 2010 under the lateral recruitment policy of CBSL.

In 2010, measures were taken to outsource the services of a Medical Officer and a Medical Nurse in the Medical Centre and an Instructor for the Gymnasium of the Bank. Meanwhile, services of some categories of staff of the Security Services Department and Restaurant of CBSL were also outsourced.

The HRD also facilitated recruitment of employees for the Poverty Alleviation Microfinance Project (PAMP) II steered by the Regional Development Department. Accordingly, the HRD facilitated for the selection of a Credit Consultant, a Training Specialist, a Marketing Specialist and a Monitoring Specialist in 2010.

### 13.3 Performance Management System

The Performance Management System of the Bank has been designed to evaluate the performance of

individual officers in terms of their contribution to achieve overall vision and mission of CBSL. At the beginning of the year, the performance evaluation process begins with the employees setting their own goals with appropriate weights for the goals, in consultation with the supervisors. Based on those goals, the employees complete the self-evaluation section of the performance evaluation form by giving a performance rating for each goal. The performance evaluation discussion is held between the employee and the supervisor in order to arrive at the final performance rating. In addition, the employee submits the learning, training and career development plans along with the performance evaluation form to the supervisor for assessment. The final performance ratings are used as one criterion for granting promotions.

Accordingly, the evaluation of performance of all employees for the year 2009 was completed on target dates. Individual and departmental goal setting for the year 2010 was also carried out concurrently as per the time targets set out at the beginning of the year.

### 13.4 Promotions

In 2010, the HRD took measures to ensure that all critical positions in the Bank are filled with competent talents. This entailed facilitating in filling the vacancies in all key positions by promoting one Assistant Governor to the post of Deputy Governor, four Heads of Department to Staff Class Special Grade as Assistant Governors and sixteen Staff Class Grade III officers as Deputy Heads of Department. In addition, the HRD ensured that a total of 156 staff members were granted their grade, class and position promotions in 2010.

### 13.5 Training and Development

Recognizing the importance of training in achieving higher performance in a skill intensive organization, the HRD continued to facilitate staff training and development through providing opportunities for its staff to participate in training programmes, workshops, seminars and part time courses offered by both local and overseas training institutions. The HRD in 2010 provided 1,641 foreign and local training opportunities covering the areas of economics, financial system stability, risk management, bank supervision, reserves

management and human resources management as compared with 1,170 training opportunities provided in 2009.

The number of officers who participated for foreign and local training amounted to 190 and 1,451 respectively in 2010.

#### (a) Foreign training

The number of foreign training opportunities provided in 2010 increased by 35 per cent to 190 as compared with 141 foreign training opportunities provided in 2009. These officers participated in a wide range of training programmes, seminars, workshops and conferences conducted by reputed training institutions abroad.

With the intention of ensuring effective utilization of knowledge gained through training programmes, the participants of these programmes were requested to undertake special assignments to initiate new activities or improve existing activities based on the knowledge gained by attending such training programmes. The Training Sub-Committee, appointed for this purpose conducted 25 pre and post-training discussions with the officers who attended foreign training programmes in 2010. Out of 74 assignments agreed, 18 assignments were completed by the end of the year.

#### (b) Post-graduate studies

In addition to the strategic focus on developing staff through local and foreign training programmes, the Bank continued its scholarship programme aiming at strengthening intellectual capacity of the staff in the Bank. In 2010, 15 officers commenced Master's degree programmes, while two officers commenced Ph.D programmes at recognised universities in the UK, USA, Japan and Australia. In 2010, 6 officers resumed duties after completion of Master's degree programmes and one officer resumed duty after completion of the Ph.D programme.

#### (c) Local training

The number of local training opportunities provided in 2010 increased by 41 per cent to 1,451 as compared with 1,029 training opportunities provided in 2009. The most of these officers participated in training programmes conducted by the Centre for Banking Studies (CBS). The number of officers who participated in the training programmes conducted by CBS and other recognized local training institutions were 976 and 475, respectively. In providing local training, the priority was given to train officers in Information Technology, Communication, Financial and Capital Markets, Bank Supervision, Macro Economic Analysis, Internal Auditing, General Management etc.

In collaboration with the Department of Official Languages (DOL), the HRD also launched a programme to facilitate the staff of the Bank to enhance their proficiency in the Tamil language. Around 200 Sinhala speaking employees participated in this programme and after completion of the programme, 114 officers sat for the written and oral examinations conducted by the DOL. Further, the HRD has organised a series of Tamil Debates to develop the language skills of the staff.

**Table II - 10**  
**Short-Term Foreign Training Opportunities - 2010**

Field	No. of Participants
Economics and Economic Policies	47
Financial Regulation and System Stability	46
Risk Management	34
Finance	4
Information Technology	6
Public Debt Management	6
Central Banking	13
Human Resources Management	25
Other	9
<b>Total</b>	<b>190</b>

### 13.6 Job Rotation

As part of job rotation programme, employees who served for more than five years in one department were transferred to some other departments, with a view of developing multi-skilled staff and enhancing overall productivity of the Bank. The staff was rotated taking into account the competency level of the officers and competency requirements of the various departments. Under this programme, a total of 20 staff members were rotated in 2010.

### 13.7 Employer- Employee Relations

The HRD continued to facilitate maintaining a close dialogue between the Trade Unions and the Management during the year 2010. Arrangements were made for the Trade Unions to meet the Management to discuss issues as and when necessary and accordingly 10 discussions were held. Such dialogue facilitated for the Management to resolve a number of issues relating to recruitment, promotions, training, welfare and general administration of the Bank and no industrial disputes occurred during the year 2010.

#### Meetings Attended by the Governor

1. Socio-economic Interactive Programme in London in February.
2. 45th SEACEN Governors' Conference and 29th Meeting of the SEACEN Board of Governors in Cambodia and Meetings in Bangkok in February – March.
3. 2010 IMF/World Bank Spring Meetings in Washington DC in April.
4. Meetings with US Government Officials, Business Community and Media, and Seminar Series on Business Opportunities in Sri Lanka, in New York & Washington, and JP Morgan's Emerging Markets Asia Conference in Singapore in May.
5. Investor Meetings in India in May.
6. Investors' Forum and Meetings in Hong Kong & Singapore in May.

7. Investor Meetings in New York in September.
8. ADB Regional Forum: "Impact of the Global Crisis on Asia, Lessons Learned, Policy Insights and Outlook" in the Philippines in November.
9. Participation in Panel of Financial and Urban Leaders of World Bank-Singapore Infrastructure Finance Summit in Singapore in November.

#### PROMOTIONS/APPOINTMENTS

1. Mr. N. A. Umagiliya was appointed as a Member of the Monetary Board by His Excellency the President with effect from 25 May 2010.
2. The following promotions and appointments were made effective during the year 2010.
  - I. Mr. P. D. J. Fernando was appointed as Deputy Governor with effect from 5 January 2010.
  - II. Mr. Y. A. De Silva was promoted to Staff Class Special Grade and appointed as Assistant Governor with effect from 15 June 2010.
  - III. Dr. W. M. Hemachandra was promoted to Staff Class Special Grade and appointed as Assistant Governor with effect from 15 June 2010.
  - IV. Mr. S. Lankathilake was promoted to Staff Class Special Grade and appointed as Assistant Governor with effect from 15 June 2010.
  - V. Mr. C. J. P. Siriwardena was promoted to Staff Class Special Grade and appointed as Assistant Governor with effect from 15 June 2010.
3. Mrs. R. Dheerasinghe, Additional Head of Department, who was on no-pay leave, resumed duties on 01 February 2010 and posted to the International Operations Department as an Additional Director with effect from 01 February 2010. Subsequently, she was appointed as the Acting Superintendent of the Employees' Provident Fund Department with effect from 21 June 2010 and as Superintendent of the same Department with effect from 21 December 2010.

4. Mr. K. D. Ranasinghe, Acting Director of the Economic Research Department, was appointed as Director and Chief Economist of the Economic Research Department with effect from 11 February 2010.
5. Mr. D. M. Rupasinghe, Acting Director of the Financial Intelligence Unit, was appointed as Director of the Financial Intelligence Unit with effect from 11 February 2010.
6. Mrs. T. M. J. Y. P. Fernando, Acting Director of the Bank Supervision Department, was appointed as Director of the Bank Supervision Department with effect from 11 February 2010.
7. Mr. R. A. A. Jayalath, Acting Director of the Domestic Operations Department, was appointed as Director of the Domestic Operations Department with effect from 11 February 2010.
8. Mr. K. B. Disakaruna, Acting Director of the Payments and Settlements Department, was appointed as Director of the Payments and Settlements Department with effect from 11 February 2010.
9. Mr. P. H. O. Chandrawansa, Acting Controller of Exchange, was appointed as Controller of Exchange with effect from 11 February 2010.
10. Mr. M. I. Sufiyan, Director of the Management Audit Department, was appointed as Chief Accountant of the Finance Department with effect from 21 June 2010.
11. Mrs. K. M. A. N. Daulagala, Chief Accountant of the Finance Department, was appointed as Director of the Department of Supervision of Non-Bank Financial Institutions with effect from 21 June 2010.
12. Mr. S. S. Ratnayake, Director of the Department of Supervision of Non-Bank Financial Institutions, was appointed as Superintendent and Registrar of the Public Debt Department with effect from 21 June 2010.
13. Mr. M. J. S. Abeyasinghe, Superintendent of the Employees' Provident Fund Department, was appointed as Director of the Policy Review & Monitoring Department with effect from 21 June 2010.
14. Mr. U. H. E. Silva, Additional Director of the Premises Department, was appointed as Acting Director of the Premises Department with effect from 21 June 2010 and as Director of the same Department with effect from 21 December 2010.
15. Mr. A. R. K. Wijesekera, Additional Director of the Human Resources Department, was appointed as Acting Director of the Human Resources Department with effect from 21 June 2010 and as Director of the same Department with effect from 21 December 2010.
16. Mr. A. M. N. Gunawardana, Acting Additional Director of the Management Audit Department, was appointed as Acting Director of the Management Audit Department with effect from 21 June 2010 and as Director of the same Department with effect from 21 December 2010.
17. Mr. K. P. N. S. Karunagoda, Additional Director of the Centre for Banking Studies, was appointed as Additional Director of the Welfare Department with effect from 21 June 2010.
18. Mr. S. M. A. Siriwardane, Acting Additional Director of the Regional Development Department, was appointed as Additional Director of the Provincial Offices Monitoring Department with effect from 21 June 2010.
19. Mr. H. Amarathunga, Acting Additional Director of the Provincial Offices Monitoring Department, was appointed as Additional Director of the Management Audit Department with effect from 21 June 2010.
20. Mr. W. R. A. Dharmaratne, Acting Additional Superintendent of the Currency Department, was appointed as Additional Director of the Human Resources Department with effect from 21 June 2010.
21. Mrs. H. P. T. Wijesuriya, Acting Additional Director of the Economic Research Department, was appointed as Additional Superintendent of the Currency Department with effect from 21 June 2010.
22. Mrs. R. B. Weerasinghe, Additional Director of the Payments and Settlements Department, was

appointed as Acting Director of the Payments and Settlements Department with effect from 26 September 2010 and as Director of the same Department with effect from 26 December 2010.

### RETIREMENTS

1. Dr. D. S. Wijesinghe, Deputy Governor, retired from the Bank service with effect from 01 February 2010.
2. Mrs. P. Liyanage, Assistant Governor, retired from the Bank service with effect from 28 January 2010.
3. Mrs. C. K. Nanayakkara, Assistant Governor, retired from the Bank service with effect from 25 May 2010.
4. Mr. K. B. Disakaruna, Director of the Payments and Settlements Department, retired from the Bank service with effect from 26 September 2010.
5. Mr. P. G. Jayasooriya, Additional Director of the Regional Development Department, retired from the Bank service with effect from 24 December 2010.

### OFFICERS ON RELEASE

1. Dr. P. N. Weerasinghe, Assistant Governor, to the International Monetary Fund as an Alternate Executive Director.
2. Mr. S. R. Attygalle, Staff Class Grade IV officer, to the Ministry of Finance and Planning.
3. Mr. K. M. M. Siriwardena, Staff Class Grade IV officer, to the Ministry of Finance and Planning.
4. Mr. C. N. Wijayasekera, Staff Class Grade IV officer, to the Ministry of Finance and Planning.
5. Mr. B. Lokuranamuka, Staff Class Grade III officer, to the Ministry of Finance and Planning.
6. Mr. H. P. M. Wasantha Kumara, Staff Class Grade II officer, to the Ministry of Finance and Planning.
7. Mr. U. V. Perera, Staff Class Grade II officer, to the Ministry of Finance and Planning.
8. Mr. M. Mahinda Saliya, Staff Class Grade II

officer, to the Ministry of Finance and Planning.

9. Mr. D. M. Wanninayake, Staff Class Grade II officer, to the Ministry of Defence.
10. Mr. W. H. M. Kumara, Staff Class Grade II officer, to the Ministry of Defence.
11. Mrs. H. P. A. Priyashanthi, Staff Class Grade I officer, to the Ministry of Finance and Planning.
12. Mr. J. A. A. Priyantha, Staff Class Grade I officer (Probationary), to the Presidential Secretariat.
13. Mrs. D. K. Uyangodage, Staff Class Grade I officer, to the International Monetary Fund.
14. Mrs. H. M. N. S. Gunawardena, Legal officer (Contract), to the Ministry of Finance and Planning.

### 14. INFORMATION TECHNOLOGY

The Information Technology Department (ITD) continued to perform a dynamic role in providing integrated and pervasive technology solutions to enhance the operational excellence of the Bank in achieving its strategic objectives. During the year, the ITD accomplished in achieving its goals in four major areas, namely, (a) Development and Maintenance of Critical Business Applications; (b) Information Communication Technology (ICT) Infrastructure Development; (c) IT Risk Management; (d) IT Value-added Services. The details are given below.

#### (a) Development and Maintenance of Critical Business Applications

The ITD continued to develop integrated and innovative business solutions across departments aligning with CBSL's theme for 2010; 'Fast track to Prosperity' to enhance the efficiency, information security and productivity of business processes while providing technical support for maintenance of all in-house developed software applications for achieving CBSL's core objectives, corporate services and carrying out agency functions in the areas of Exchange Control, Employees Provident Fund, Management of Public Debt and Financial Intelligence unit.

Some of the major applications completed during the year are as follows.

- Implementation of a e-Trade Database to record import and export data from Sri Lanka Customs to monitor performance of external sector and analytical work and preparation of trade index by the Economic Research Department.
- Implementation of re-designed VideshaVinimaya system for the reporting of inter-bank foreign exchange transactions to analyze market information for information backed decision making.
- Expansion of existing ForexNet application to cater to the needs of enhanced monitoring of foreign exchange sales to migrants and accommodating the Share Investment Account reporting system under the liberalized exchange control policies.
- Development of an International Operations Management System to facilitate the collection and reporting of domestic financial market information.
- Implementation of a software application to centrally compute and make bonus interest payments to senior citizens through Sri Lanka Interbank Payment System to comply with the government decision.
- Implementation of enhanced Sri Lanka Interbank Payment System using high end technology with integrated security features to accommodate high volume of transactions and T+0 settlement facilities with multiple clearing cycles a day.
- Facilitation with system changes to SWIFT to support straight through processing of payment messages.
- Implementation of a visitor permission system to facilitate the granting of online entry permits for visitors as a measure of image building of the Bank.
- Implementation of an online integrated

procurement system to facilitate the entire procurement process of the Bank in a more efficient manner.

- Implementation of a web application facilitating to conduct public sector employment survey to record and analyze key employment statistics of public sector for identification of strength and trends of labour force.

Major milestones achieved during the year were successful implementation of the EPF re-engineering project for enhanced efficiency for its current business processes through greater integration among different sub-systems aiming at providing an efficient service for processing refunds and conducive environment for fund investment and upgraded LankaSettle/LankaSecure application software (CAS/CSS 3.5) to incorporate enhanced business functionalities for automated ILF management to maintain compliance with international best practices.

Full maintenance of all existing IT systems which were developed in-house was carried out and maintenance support for procured IT systems was extended to oversee that the vendors supplied the maintenance services complying with the terms of service contracts. The ITD was able to achieve over 99.7 per cent system availability for Systemically Important Payment and Settlement Systems (SIPSS) during the year. Meanwhile, the rest of the IT systems which are in operation, the department was able to maintain almost 100 per cent operational availability in 2010.

#### (b) ICT Infrastructure Development

The ITD continued to develop ICT infrastructure during the year to support and enable the provisioning of a multiplicity of applications and services. The bandwidth of the internet leased line capacity was increased to 10 Mbps from 6 Mbps, to facilitate the enhanced need for research and development of the CBSL staff while providing improved access to web applications deployed by the CBSL. The local area and wide area network

of the CBSL were further secured to minimize internal and external security threats. The infrastructure of the main server room was further strengthened to enhance the physical security, minimizing possibilities of security breaches.

### (c) IT Risk Management

With the understanding of essentiality of Business Continuity Planning (BCP) to meet the stringent business operational requirements of CBSL, the BCP of the CBSL was reviewed and updated regularly while conducting two BCP drills during the year from the Disaster Recovery Site (DRS) with the participation of the Bank staff and external financial institutions namely licensed commercial banks, primary dealers and Lanka clear (Pvt) Ltd. ITD provided technical expertise to review the operational capability of DRS locations of LankaSettle participants to ensure that the SIPSS has mitigated its operational risk.

### (d) IT Value-added Services

The ITD continued to provide technical assistance to IT related operations and to technical evaluation committees for IT related procurements in the CBSL. ITD helped in preparing request for proposals and evaluating bids for establishing a fully fledged trading platform for the foreign exchange trading and investment operations.

With a view to providing uninterrupted IT support services to the staff, IT Help Desk services were maintained from 0700 to 1830 hours during all working days. Technical expertise and advisory services were provided to other external organizations and for projects of national interest such as drafting of technical guidelines for Internet banking, mobile banking and sending government payments through electronic payment cards and a high level policy document for registered finance companies recommending information system guidelines to be adhered. Steps were taken to set-up a computer security incident reporting team for the financial sector with the coordination of Information and Communication Technology Agency (ICTA).

For enhancing the IT knowledge, continuous training and opportunities for exposure on technology advancements were provided to the staff of the CBSL and other financial institutions during the year. IT usage policy document was finalized enforcing effective utilization of IT resources of the CBSL. Special emphasis was placed on enhancing IT security by conducting awareness programmes and facilitating information system audits by internal and external auditors.

## 15. INTERNATIONAL OPERATIONS

The International Operations Department (IOD) is entrusted to perform the international reserves management function. During the year 2010, the IOD managed its international reserves in an effective manner and achieved a remarkably high rate of return from its investments. The IOD which is also responsible for monitoring the domestic foreign exchange market took appropriate measures to ensure its smooth operations during the year under review.

### 15.1 International Reserves Management

The recent international financial crisis posed many a challenges to global reserve management. The Euro debt crisis that spilled over to the entire globe in 2010 resulted in a significant volatility in major currencies and bond yields. Under these circumstances, CBSL had to perform a challenging task in managing its international reserves prudently while maximizing the returns and minimizing the risk involved. The timely actions taken and prudent risk management and diversification techniques adopted by IOD assisted in preserving the reserve portfolio of CBSL. Accordingly, the euro debt crisis did not make a major impact on CBSL exposure to European region due to timely risk mitigation actions taken on the investments held in the volatile markets.

The foreign reserves of the country surged to a significantly high level with the improved investor confidence after the end of the 30-year long conflict and stable economic and political conditions that prevail in the country. The international bond issue and the IMF Standby Arrangement Facility largely contributed to improve the reserves, which rose to a historic high level in Sri Lanka of over US dollars 6.6 billion by end 2010.



During the year under review, investments of the international reserves were undertaken in accordance with the Foreign Exchange Reserves Management Guidelines approved by the Monetary Board and under the supervision of the Foreign Reserve Management Committee (FRMC). The international reserves which are denominated in currencies such as US dollars, Euros, Sterling pounds, Australian dollars and gold were invested mainly in two asset classes namely, Fixed Income Securities and money market instruments. Bank's Fixed Income Securities portfolio consisted of highly rated government securities, government guaranteed securities, and securities of government agencies and supranational institutions. The investments on both fixed income securities and money market were performed only through highly rated banks and investment houses which are counter parties approved by the management, paying due consideration to safety, liquidity and return on such assets. Liquidity requirements of CBSL, debt service repayments, risk management parameters, income generating abilities and specific directions of the Monetary Board were the key factors considered in determining the asset and currency composition of the reserves portfolio.

CBSL's overall reserve management operations have generated a net foreign income of US\$ 338 million (Rs. 37 billion) during the year 2010. In the midst of comparatively low interest market environment, progress was made under challenging circumstances in generating a significant income through foreign currency trading with the maximum use of the market fluctuations and capital gains derived on fixed income securities. In addition, a remarkable return on gold trading due to unrivalled price volatility in the global commodity market contributed the most to the increase in the total return.

In view of the expanding reserves, it was decided to enhance the operations of IOD by expanding the scope and extent of the foreign reserves management activities. This entailed an increase in the staff allocation, modernization of physical infrastructure, multiple shift working arrangements, changes in the investment horizon and work relating to the procurement of a Treasury Management System

(TMS). Accordingly, during the year under review IOD increased its number of dealers from 11 to 20, set up a modern dealing room with appropriate furniture, fittings and equipment, extended its working hours, moved certain investments into emerging markets and was in the process of finalising the selection of a vendor for the supply of TMS. These activities are expected to assist the effective management of the foreign reserves and further increase the efficiency of the systems and procedures adopted in managing the international reserves.

## 15.2 Risk Management

The Middle Office of IOD engaged in monitoring and measuring the risks associated with the investment of international reserves continuously during the year under review. The investments of international reserves were exposed to various categories of risks, of which exchange rate risk, interest rate risk, credit risk, liquidity risk and operational risks were considered as major components.

CBSL managed the exchange rate risk or the currency risk effectively with portfolio diversification and appropriate currency combinations set in line with the impending foreign currency liabilities. Interest rate risk is the risk (variability in value) borne by an interest-bearing asset, due to variability of interest rates. In general, as rates rise, the price of a fixed rate bond will fall, and vice versa. This risk was mitigated by diversifying the durations of the fixed income investments and other related money market investments in approved currencies. Counterparty Credit Risk Management System (CCRMS), which is an internally developed system that facilitates a comprehensive evaluation of the counterparties based on financial indicators, credit ratings and their market exposures, was used by IOD to manage the counterparty credit risk. The liquidity risk was managed by forecasting cash flows and analyzing maturity profile of assets and liabilities while maintaining a sufficient proportion of assets in highly liquid form. Stress testing played a major role in the liquidity risk management framework as well. The operational risk arising from the people, systems and processes were managed through measures such as strengthening of the verification process, improvements

to the trading system and updating of the investment guidelines.

### 15.3 Domestic Foreign Exchange Market Developments

IOD continued to closely monitor the domestic foreign exchange market, foreign exchange transactions and overnight net foreign exchange positions of the commercial banks with a view to promoting the smooth functioning of the domestic foreign exchange market and to ensure an orderly adjustment of the exchange rate.

The rupee appreciated during the year 2010 mainly due to the rise in foreign currency inflows (export proceeds, inward remittances on account of stock market investment, international bond issue). During the year 2010, CBSL played an active role in the foreign exchange market to mitigate the volatility of the exchange rate which resulted in a gradual appreciation of the rupee against major currencies. The total amount injected to the domestic foreign exchange market by CBSL was US dollar 820 million and the amount absorbed was US dollar 753 million resulting in a net sale of US dollar 67 million during the year under review.

The Sri Lanka rupee appreciated by 3.09 per cent against the US dollar in 2010. It moved from Sri Lanka rupees 114.38 per US dollar as at end 2009 to Sri Lanka rupees 110.95 per US dollar as at end 2010. The volume of inter-bank foreign exchange transactions which amounted to US dollar 10.96 billion in 2009 increased to US dollar 11.06 billion in 2010 recording a one per cent increase. The process of providing information on exchange rates of Sri Lanka rupee against other currencies to government departments, corporations, local and foreign agencies and other users continued during 2010 as in the previous years.

**Table II-11**  
**Inter-Bank Foreign Exchange Transactions**  
**Volume – 2010**

(US\$ mn)

Months	Spot	Tom	Cash	Forward	Total
January	320.48	151.45	104.19	257.53	833.65
February	273.55	150.78	40.75	213.64	678.72
March	449.98	172.08	99.50	353.53	1075.09
April	409.65	83.95	111.85	225.72	831.17
May	338.05	81.20	76.75	220.96	716.96
June	420.85	110.70	99.45	291.01	922.01
July	457.94	138.80	84.45	555.10	1236.29
August	385.40	154.15	112.73	418.82	1071.10
September	423.08	94.90	92.12	295.51	905.61
October	529.46	92.50	64.15	290.83	976.94
November	337.35	132.90	52.75	221.31	744.31
December	574.45	88.78	106.45	304.25	1073.93
Total	4920.24	1452.19	1045.14	3648.21	11065.78

Source: International Operations Department, Central Bank of Sri Lanka

**Table II-12**  
**Purchases and Sales of Foreign Exchange by the**  
**Central Bank – 2010**

(US\$ mn)

Months	Purchases	Sales	Net
January	27.25	34.15	(6.90)
February	28.50	80.85	(52.35)
March	44.55	4.00	45.00
April	199.40	79.65	119.75
May	62.50	-	62.50
June	59.50	25.85	33.65
July	101.10	9.75	91.35
August	87.00	65.40	21.60
September	37.50	106.60	(69.10)
October	35.50	324.20	(288.70)
November	-	89.35	(89.35)
December	70.40	-	70.40
Total	753.20	819.80	(66.60)

Source: International Operations Department, Central Bank of Sri Lanka

## 16. MANAGEMENT AUDIT

The Management Audit Department carried out objective assurance and consultancy services to add value and to improve the operations and systems of controls of CBSL in order for it to achieve its objectives effectively. In this regard, the Department evaluated the effectiveness of the risk management, controls and governance processes and made suggestions and recommendations depending on requirements.

Adherence to globally accepted standards, best practices and the maintenance of the quality of audit activities are important pre-requisites in offering assurance and consultancy services. In that regard, the Department implemented a number of measures that were recommended in the Quality Assessment Report submitted by the Columbus Advisory Sdn. Bhd. in collaboration with the Institute of Internal Auditors – Malaysia. Accordingly, the Department adopted the auditing standards of the Institute of Internal Auditors. In line with that, the activities of the department were partially transformed to risk based audit methodology from compliance based audit methodology. Thus, part of the Annual Audit Plan (AAP) of the year was prepared on risk based methodology.

The Department took actions to move away from its involvement in managerial activities and accordingly, most of the pre-audit activities were discontinued at the end of year 2010. In order to enhance the quality of audit activities and to move forward with the best audit practices, the concept of exit meeting was introduced and accordingly such meetings were conducted before issuing audit reports.

The Department took more efforts to enhance the staff strength and their competencies during the year. Accordingly, the Department was able to strengthen its human asset with the support of the senior management and the Human Resources Department. In addition, the Department was able to train its staff in audit and other related disciplines such as risk management, control and governance by nominating them for local and overseas programmes. Also, the officers were trained in treasury management, monetary policy, office procedures and other related subjects. In-house

training sessions on accounting standards were also conducted for the benefit of the audit staff.

Further, the Department took several measures to enhance the competencies of information system (IS) audit staff. Officers were nominated to attend local and overseas training programmes and also they were given on-the-job training. Also, in-house training sessions were conducted to train the staff to utilize Audit Command Language (ACL) in retrieving and analyzing data in performing the audits.

The Department obtained the services of an audit firm on outsource basis to prepare the risk based audit plan for the year 2011. The major reason behind the obtaining of the services was to transform all audit activities towards the risk based audit methodology.

While focusing on the improvements to the audit function as explained above, the Department carried out its internal audit activities facilitating the Bank to achieve the targets specified in the Strategic Plan 2010 – 2014 by providing value added assurance and consultancy services on operations and processes of other departments and systems and controls by conducting audit assignments set out in the AAP of 2010.

The Department performed a comprehensive process study to ensure the accuracy of the Net International Reserves (NIR) and Reserve Money (RM) data reporting methodology of the Economic Research Department. This assignment enhanced the validity of the NIR and RM data reported to the International Monetary Fund (IMF). In line with that, the Department was engaged in verification of data reported to the IMF on three test dates; March, June and September, 2010.

The other major audits conducted during the year include full scope review on Counterparty Credit Risk Management System, review on the measures taken to streamline the National Payment System, assessment on the compliance of the Scripless Securities Settlement System/Central Depository System with the recommendations of the Bank for International Settlements and review of the activities of provincial offices. Also, the Department carried out a number of

audits including routine audits on the area of currency issue and management. In addition, the Department deployed its staff in the Currency Department to observe the carrying out of its operations. Further, the Department stationed its staff in the Payments and Settlements Department to conduct continuous audit on reserve management activities. Also, a number of audits were conducted in reserve management area in line with the AAP of 2010. IS audits were conducted on Information Security Policy, software developments, Payroll System and Business Continuity Plan. Also, the Department used ACL software to obtain information from computerized data bases when carrying out audits.

Follow-up of audits conducted in 2008, 2009 and first half of 2010, provisioning of services requested by the management, attending to pre-audit requirements of the Secretariat and Welfare Departments, carrying out of leave audits were the other activities the Department carried out during the year.

The Department reported the audit observations to the auditee departments as and when audits were finalized. Such observations together with responses received from auditee departments were reported to the Governor, Monetary Board Advisory Audit Committee and the Monetary Board at regular intervals and, on half yearly basis to the Auditor General during the year.

## 17. PAYMENTS AND SETTLEMENTS

The Payment and Settlement Systems Act No. 28 of 2005 entrusted the CBSL with a legislative mandate to regulate and oversee the payment and settlement systems in the country and to implement the national payment system policy with the objective of ensuring safety, efficiency, competitiveness and stability of the payments and settlements infrastructure in Sri Lanka. To achieve these objectives, the CBSL carries out the mission of providing safe, sound and efficient payment and settlement systems through the Payments and Settlements Department (PSD). The PSD continued its operations of the Real Time Gross Settlement (RTGS) System, which is the systemically important large value inter-bank payment and settlement system, the back office functions to process and effect payment and settlement instructions in respect of CBSL's foreign

exchange reserve management and to execute dealings with regard to Open Market Operations of CBSL, and management of the SWIFT transaction communication system. Further, in order to ensure smooth operations of the payment and settlement systems and to mitigate potential risks that could affect the payment system stability, the PSD is entrusted with its policy formulation and oversight activities as well. In addition, the PSD continued to facilitate settling of fund transfers among Asian Clearing Union (ACU) member countries through ACU mechanism and maintaining the SAARC Payment Initiative (SPI) Secretariat at the CBSL with the objective of strengthening the regional co-operation.

### 17.1 Operating the Real Time Gross Settlement (RTGS) System

PSD continued settling of time critical inter-participant payments in the financial market as well as their customer payments on real time gross basis through the LankaSettle system. During the year, PSD attended to making upgrades to this system to accommodate expanding transaction volume requirements and technology developments. PSD provided help desk services to participants throughout the operating hours of the system during the year 2010. The total volume of transactions settled by the RTGS system during the year was 246,824 with a total value of Rs. 47 trillion. RTGS recorded its highest volume of 1,729 transactions and value of Rs. 446 billion in a day during the year 2010. The average volume and value of transactions settled per day was 1,024 and Rs. 198 billion, respectively. Meanwhile, the PSD facilitated and monitored the fund releases under the Intraday Liquidity Facility (ILF) around Rs. 11.4 billion per day to the RTGS participants who requested extra funds through ILF, to ensure the smooth flow of transactions settled through the LankaSettle system.

As at end 2010, participants in the RTGS system consisted of CBSL, 22 Licensed Commercial Banks (LCB), 6 non-bank Primary Dealer companies, Employees' Provident Fund (EPF) and the Central Depository System (CDS) of the Colombo Stock Exchange. Seylan Bank Asset Management Ltd, a Primary Dealer participant, was amalgamated with Seylan Bank Ltd during the year and therefore, the total number of LankaSettle participants

reduced to 31 as at end 2010. As a performance indicator, the PSD was able to maintain the system availability of 99.72 per cent during the year 2010. In order to ensure the readiness of the system during contingency events, two live operation sessions were conducted successfully at the secondary site during the year and arrangements in the disaster recovery site was further strengthened. Each participant institution (PI) was also encouraged to upgrade business continuity plans in their respective institutions, in line with the guidelines issued by the CBSL.

In February 2010, the procedure of granting ILF to PIs was upgraded to provide ILF facility to PIs at their discretion, deviating from the prevailed practice of providing ILF only on the request of PIs during a given time period of each day. Further, a mechanism was introduced to the LankaSettle system to deal with daily transactions in the events of unpremeditated holidays. Meanwhile, based on the decision taken to implement a cost recovery mechanism, the transaction fee of RTGS was increased from Rs. 400/- to Rs. 420/- with effect from 1st May 2010.

### **17.2 Settlement of Deals under Foreign Exchange Reserve Management**

During the year 2010, the PSD continued to operate the back-office functions pertaining to foreign exchange, gold and foreign securities transactions by providing smooth and reliable settlement process through the Treasury Dealing Room Management System (TDRMS) for transactions carried out by the International Operations Department (IOD). The PSD settled 19,030 transactions amounting to US Dollars 139.45 billion during the year. The observed significant feature during the year was the increase of the transaction volume by 165 per cent in 2010 when compared with 2009.

The increase of transactions on forex, gold and foreign securities carried out by IOD as a result of the substantial increase in the foreign reserves of the country during the recent past has led IOD to initiate a project on modernization of the dealing room operations to meet expected growth in the future transaction volumes, support dealing room operations in multiple shifts, expand the scope of trading portfolio

and in compliance with best international standards. In line with this development, the PSD adopted necessary measures to enhance its human and operational capacity to manage the high volume of transactions and conducted meetings with IOD officials to resolve operational issues on the settlement process. In addition, the PSD was actively involved in dealing room modernization project as well, by providing inputs with regard to back office requirements and participating in the process of evaluating technology solutions submitted by selected vendors. Further, the PSD participated for upgrading the existing TDRMS to achieve Straight Through Processing (STP) in line with the Euro Clear system enhancements.

### **17.3 Settlement of Transactions under Open Market Operations (OMO)**

The PSD, on behalf of the CBSL, continued discharging its responsibilities on allocation of securities of CBSL portfolio in OMO transactions with PIs. Thus, PSD during the year 2010 effected 8,201 transactions on repo amounting to Rs. 10,723 billion, 37 transactions on outright sales amounting to Rs. 13.3 billion, and 1,270 transactions on Central Bank Securities amounting to Rs. 1,467.0 billion. There were no outright purchase transactions during the year 2010. Extending the back office function for OMO transactions, the PSD performed the provision of intra-day liquidity for participants and monitored the settlement of ILF, facilitating for 7,427 transactions under ILF, amounting to Rs. 2,747.3 billion.

### **17.4 SWIFT Communication**

Management of SWIFT communication system of the CBSL was carried out by the PSD in accordance to the procedures laid out by the SWIFT Center such as governance arrangements, structures, processes, risk management procedures and controls.

In 2010, the total number of SWIFT messages sent and received were 1,538,588 and 816,060 respectively. Out of the total messages received 212,480 were for the CBSL transactions while the balance was for RTGS and securities related transactions.

### 17.5 Transactions under the Asian Clearing Union (ACU)

The total value of transactions effected by Sri Lanka through the ACU mechanism increased substantially by 62 per cent from Rs. 190.7 billion in 2009 to Rs. 309.8 billion in 2010. This was mainly due to the renewal of payments to Iran, for oil imports to Sri Lanka through the ACU mechanism. The total volume of transactions effected through the ACU mechanism increased by 16 per cent in 2010. As a result, the rupee value of net settlements made under the ACU mechanism also increased to Rs. 265.2 billion in 2010 from Rs. 158.5 billion in 2009.

**Table II - 13**  
**ACU Transactions of Sri Lanka with other ACU Countries**

	Rs. billion	
	2009	2010
Total transactions channeled through ACU	190.7	309.8
Sri Lanka's exports to other ACU countries	67.0	85.0
Sri Lanka's imports from other ACU countries	339.6	428.4
Sri Lanka's total trade with other ACU countries	406.6	513.4
Net ACU Settlement	158.5	265.2

Source: Central Bank of Sri Lanka

As per the decision taken at the 38th meeting of the Board of Directors of ACU, the Republic of Maldives was granted the membership of the ACU and hence the Maldivian Monetary Authority commenced ACU operations in January 2010, increasing the number of member countries of the ACU to 9. The 39th meeting of the Board of Directors of the ACU, which was held in Bhutan in June 2010, focused mainly on the recommendations made by the ACU Technical Committee convened by the Reserve Bank of India (RBI). The Board of Directors unanimously approved the following recommendations:

1. Improvement of ACU mechanism by conducting awareness seminars for commercial banks, trade bodies, chambers of commerce etc; setting

up of systems and processes to address issues/ disputes by the respective country authorities; and develop a web-based application to be used across member nations and ACU secretariat for messaging, accounting and reconciliation.

2. Expanding the scope of ACU by continuing the existing SWAP facility with two months settlement; exploring the usage of domestic currency and its appropriateness and feasibility; and setting up an ACU Trade and Development Bank with the aim to enhance monetary cooperation, and introduction of trade finance schemes.

It was decided to appoint a Standard Technical Committee to explore the suggestions made to expand the scope of ACU. The 40th Meeting of the Board of Directors of the ACU is scheduled to be held in India in 2011. Following the principle of rotation, during 2011, the Chairmanship of the ACU will be held by the Governor, Reserve Bank of India and the Vice Chairmanship by the Governor, Central Bank of Islamic Republic of Iran.

### 17.6 Payment System Policy and Oversight

The PSD continued its regulatory and supervisory activities to ensure payment and settlement system stability in order to achieve the overall objective of financial system stability of the country throughout the year. The main focus of the oversight policy with regard to payment and settlement systems during the latter part of the last decade has been on the electronic retail payment systems. More importantly, having considered the risk of unregulated payment card industry and the negative effect that could have on the financial system stability, the PSD, in 2009 took steps to issue the Service Providers of Payment Cards Regulations No.1 of 2009 (Regulations) which provide the CBSL with the legislative mandate to regulate and supervise service providers engaged in payment card business. The Regulations require each service provider of payment cards operating in Sri Lanka to obtain a licence annually to carry out payment card business. Accordingly, the PSD, after evaluating the applications received, issued licences to 17 service providers of payment cards in 2010 to carry on their

business. Further, as per the authority granted by the Regulations to issue directions, guidelines and circulars to regulate the payment card industry, the PSD issued Credit Card Guidelines No. 1 of 2010 in March 2010 and initiated off-site surveillance based on the Guidelines as well. The objectives of these Guidelines were to ensure safe, secure and efficient operation of the credit card industry and to protect the interests of the cardholders. In addition, as per the instructions made by the PSD, the Payment Card Industry Association of Sri Lanka is in the process of preparing a code of conduct for the credit card issuers. The code of conduct, which is expected to be finalized in 2011, will act as a benchmarked service standard for card issuers dealing with individual cardholders.

Furthermore, having considered the emerging tendency in the financial market in expanding the mobile phone based payment means, the PSD drafted a set of guidelines to regulate mobile phone based payments, in order to create a secure environment for such payments. The draft mobile payment guidelines were published in the CBSL website for public comments in 2010. It is expected to finalize and release the mobile payment guidelines during the first quarter of 2011.

In fulfilling one of the action points in the road map of the National Payment Council (NPC), the Sri Lanka Interbank Payment System (SLIPS), one of the major retail payment systems in the country, operated by the LankaClear (Pvt) Ltd., (LCPL) was upgraded to an on-line payment system in 2010 to provide settlement on the same business day (T+0 basis). Therefore, in order to set out minimum prudential requirements for LCPL and the Participants of the SLIPS, the PSD prepared a Direction on SLIPS operations which will be issued during early 2011.

The PSD continued to evaluate the business continuity arrangements of LankaSettle Participants during 2010 in order to ensure the operational reliability of the systemically important payment system. Accordingly, as the second phase of evaluations, the PSD supervised the conducting of test runs by Pls from their Disaster Recovery (DR) sites and implementing of the recommendations made during the first phase

of evaluations to improve their Business Continuity Plans (BCP). During the year 2010, DR sites of 18 Pls were inspected and recommendations were given to improve their DR sites. In addition, the DR sites of LCPL and Lanka Financial Service Bureau, were also inspected during 2010.

With the introduction of the Cheque Imaging and Truncation (CIT) system, it was expected to reduce the cheque realization time to T+1 island-wide. In order to understand the customer view on the cheque realization process and the time taken to realize cheques, the PSD, on the recommendation of the NPC, conducted a customer survey in 2009, with the assistance of the Statistics Department and the Regional offices of the CBSL, covering the entire country except the Northern and Eastern Provinces. The survey report, which was finalized in 2010, revealed that customers do not have clear knowledge on the cheque realization process and T+1 rule applied by the CBSL on the process. Therefore, the PSD instructed all licensed commercial banks to adhere to the Directions issued by the CBSL on CIT system and adopt necessary measures to increase customer awareness on the cheque realization process.

During the year 2010, the PSD continued to publish the quarterly Payments Bulletin in the CBSL website for dissemination of information on payment and settlement systems in the country. Further, the PSD conducted awareness programmes to educate the general public and the banking community on payment systems and other related issues.

### 17.7 SAARC Payments Initiative

On behalf of the member countries, the PSD continued to maintain the SAARC Payment Secretariat (SPC) in 2010. The website of the SPI was maintained and updated with the information on the progress of the SAARC Payments Council and SPI. During the year 2010, 4th and 5th volumes of the SAARC Payments Bulletins were published. The PSD facilitated to organize the 7th SPI meeting in Bangladesh and 8th SPI meeting in India and continued to attend to all secretarial work on behalf of the member countries.

## 18. POLICY REVIEW AND MONITORING

The Policy Review and Monitoring Department (PRMD) engages in activities relating to conducting reviews, studies or researches on policies adopted by the CBSL and updating the policy and procedure library regularly, coordinating the strategic planning process and updating the Strategic Plan of the CBSL on a rolling five year period, conducting strategic plan workshop and survey, and monitoring the progress of activities of each department quarterly.

### 18.1 Conducting Policy Reviews

Several policy reviews and studies were undertaken during the year with the concurrence of management and based on such reviews and studies policy recommendations were submitted to the management. These reviews and studies included; Credit delivery after relaxation of monetary policy, Potential for development in the North and the East after the civil war, and Impact of the war on tourism.

During the year, the on-line e-policy and procedure library was updated with directions, guidelines and publications issued by departments of the Central Bank. The e- policy and procedure library is accessible through the CBSL's e-mail system.

### 18.2 Implementing Strategic Plan 2010 - 2014

During the first week of January 2010, a two day workshop was conducted for all staff members of the CBSL to familiarise themselves with the Strategic Plan 2010 - 2014. The workshop sessions were organized on a cluster basis to enable the staff to better understand their role in the process and make an effective contribution to enhance the productivity of the CBSL. A survey which was conducted as part of the workshop indicated that the staff of the Bank possesses a high level of awareness on the main elements of the strategic planning process. The members of the staff have also suggested to continue the practice of conducting the workshop on strategic plan of the CBSL annually.

Strategic Plan 2010-2014, the fourth Strategic Plan of the CBSL carrying the theme of **"Fast Track Prosperity"**, was successfully implemented during 2010. The CBSL recorded an average achievement rate of more than

91 per cent of the work earmarked for 2010 to its departments and provincial offices. Each department was well geared to complete their key activities within the specified time targets enhancing the efficiency and productivity of the CBSL. Clear understanding of the strategic planning objectives, responsibilities and commitment of the staff towards achieving Strategic Plan goals were instrumental to achieve this success rate.

Quarterly progress review meetings with the departments to evaluate the performances of the departments were conducted as scheduled. The levels of performance of the departments were reported to the Strategic Planning Review Committee (SPRC) which is chaired by the Governor and comprised of the corporate management of the CBSL. On the basis of these monitoring reports, the management was able to identify drawbacks and deficiencies of implementing the Strategic Plan and take remedial action to implement the Strategic Plan.

### 18.3 Coordinating the strategic planning process 2011 - 2015

The PRMD successfully concluded its fifth strategic planning retreat under the theme of **"Repositioning for a new Era"**. This theme on one hand, highlights the dawn of a new era for Sri Lanka with the end of the three decade long conflict, creating space of unprecedented opportunities to revive the country's economy at a faster pace and on the other hand, it stresses the need to move forward with strong focus on re-inventing, re-orienting and re-positioning the Sri Lanka economy while achieving the core objectives of the CBSL. The two day strategic planning retreat was held at Heritance, Kandalama with the participation of all Heads of Department, their representatives and senior management during 1-3 October, 2010. The purpose of the Retreat was to review the current strategic plan and update it on a rolling five year period of 2011 – 2015 with a view to repositioning the activities of the CBSL to be consistent with the declared goal of the government of doubling the country's per capita income by 2016. The PRMD held pre-retreat meetings with all the CBSL departments to ensure that the theme of the strategic plan is effectively focused in the departmental strategic planning process.



## 19. PREMISES

In addition to the several major refurbishment projects undertaken during the year, the Premises Department (PRD) in 2010 continued to carry out its primary functions of maintenance and upkeep of the Bank's premises and maintenance of a high degree of operational reliability of all critical services provided by the Department. In supplying critical services of electricity, air conditioning, water supply and communication, the PRD was able to achieve almost 100 per cent reliability in 2010, contributing to ensure Business Continuity Plan of the Bank.

In order to facilitate the 60th Anniversary celebrations, a major upgrading and modernization project commenced in 2010 at the Centre for Banking Studies (CBS) at Rajagiriya. The CBS auditorium was upgraded to provide state-of-the-art facilities for participants introducing an architecturally pleasing interior design. Improvements introduced to enhance the outlook of the main building, its environment, sanitary facilities, paving, landscaping and colour washing were required to elevate the position of CBS to a modern international training centre.

The refurbishment works of the Lloyd's Building, a new addition to the CBSL properties, were carried out in a speedy manner by deploying additional staff strength for the critical activities. CBSL professional staff as well as outsourced consultants contributed to achieving high standards of construction quality in restoring the appearance of this historic building to its original glory. Renovation plan for the National Mutual Assurance Building located opposite the CBSL Head Office premises was also finalized in 2010 and renovation work is expected to commence in 2011.

The Premises Department was able to successfully complete the construction of the new Holiday Homes in the Somawathiya National Park in 2010. Upgrading of facilities at the Holiday Homes at Anuradhapura, Kataragama and Nuwara Eliya was undertaken in 2010 and is expected to be completed in the first quarter of 2011. Arrangements are under way to renovate the auditorium of the North Central Provincial Office, which is more than 25 years old, to a modern outlook. During the year, the auditorium

of the Central Provincial Office was also upgraded with air conditioning facilities. In order to facilitate the expansion of the activities of CBSL in the Northern and Eastern Provinces, the PRD also played a major role in providing necessary buildings and other facilities to establish the new Provincial Offices in those provinces.

The PRD undertook several upgrading projects at the Head Office Buildings including expansion and modernization of the Dealing Room, and the modernization of the Conference Hall No. 3 to international standards. Arrangements are under way to construct a six-storied car park adjacent to the Flagstaff Street entrance to the CBSL Head Office premises. Vehicle fleet of the PRD was also strengthened during the year to meet the demand arising from expansion of operational functions of the CBSL.

In 2010, the PRD has taken steps to strengthen its team of professional staff with new recruitments and training in line with the policy to have both in-house and outsourced technical expertise to mitigate operational risk and for quality assurance.

## 20. PROVINCIAL OFFICES MONITORING

### (a) Monitoring the functions of Provincial Offices

The Provincial Offices Monitoring Department (POMD) which was established in 2009, continued its operations with a view to monitoring the performance of Provincial Offices (POs) in line with policy objectives of CBSL. Further, in terms of Section 7 of the Monetary Law Act, new POs were established in Jaffna and Trincomalee in 2010 with a view to provide financial and other support services required for economic development activities commenced in the Northern and Eastern Provinces subsequent to the end of decades long conflict.

One of the strategic objectives of POs is to extend financial support to productive sectors to achieve balanced economic development among the regions. In order to achieve the regional development objectives, POs perform an active role in the implementation of special credit lines operated by CBSL. Further, POs conduct

awareness and skills development programmes for prospective entrepreneurs and support the low income groups to enhance their income generating capacity through inclusive finance.

**(b) Region specific development activities**

POs are paying continuous attention on the regional development initiatives and identifying innovative region specific projects and schemes that are appropriate to enhance production and income levels of different segments of the people in the provinces. PO in the North-Central province has extensively engaged in facilitating Participatory Financial Institutions (PFIs) to recover the loans granted to maize cultivators that had been defaulted and as a result the recovery ratio of this sector which was reported as 67 per cent in 2008/2009 Maha season increased to 82 per cent in 2009/2010 Maha season. PO-NCP was able to make arrangements for farmers to sell their output at a pre-determined remunerative price under the Forward Sales Contract (FSC) system. Similar arrangements were made in respect of other crops such as black gram, soya bean and green gram during the year under review. POs in the Central and North-Central provinces have taken measures to promote the production of B-onion seeds with the assistance of the Department of Agriculture. All POs coordinated relevant activities with government and private sector organizations to increase the crop production in the provinces

through the introduction of best farming practices. Similarly, POs participated in the promotion of Agro-Livestock Development Loan (ALDL) scheme introduced by CBSL with a view to increase local liquid milk production in the country.

**(c) Awareness Programmes and Skills Development Programmes**

Awareness programmes have been conducted by POs for the general public as well as for the officials engaged in the provincial level development activities. All POs engaged in making the people in regions aware of the development credit schemes introduced by CBSL, Forward Sales Contract (FSC) System and further, conducted special seminars on different financial related topics, i.e. investment on government securities, promotion of saving habits, identification of forged currency notes, illegal financial business and other general and current financial issues. A large number of skills development programmes have been conducted by POs covering a wide range of subject areas such as hi-tech agriculture, scientific dairy farming, home-gardening, mushroom cultivation, coir based products, bee-keeping, horticulture and post-harvesting techniques in association with relevant institutions in the provinces. The progress of programmes conducted by the POs during the year 2010 is given in the table.

**Table II - 14**  
**Progress of Programmes Conducted by Provincial Offices**  
**During the Year 2010**

Name of the Provincial Office	Awareness Programmes conducted		Skills Development Programmes conducted	
	No. of Programmes	No. of People Participated	No. of Programmes	No. of People Participated
Southern	205	6,225	18	641
North-Central	100	6,825	33	1,001
Central	193	4,108	43	1,282
Northern	38	1,089	-	-
Eastern	08	100	-	-
All Provincial Offices	544	18,347	94	2,924

### (d) Logistic Support

The logistic support extended by POs to CBSL includes the participation of surveys, arrangement of seminars and awareness programmes, attending to member-inquiries on Employees' Provident Fund, sale of commemorative coins and publications of CBSL and provincial level arrangements for the quiz competition conducted to commemorate the 60th Anniversary of CBSL. POs assisted other Departments of CBSL in several occasions by deploying the staff attached to POs to conduct field level investigations, surveys and other activities in the provinces.

## 21. PUBLIC DEBT

The Public Debt Department (PDD) continued to carry out the functions of public debt management during 2010. A key function in this respect was the raising of funds to meet the funding requirements of the government at the lowest possible cost having regard to maintaining the risk at a prudent level, and timely servicing of public debt. In order to carry out these functions effectively, PDD in 2010 adopted several measures to strengthen public debt policy, enhance the use of IT infrastructure and to maintain greater stability of the primary dealer (PD) system, to improve the efficiency of public debt management and to develop the domestic debt market. The debt management strategy in 2010 was focused on the effective implementation of risk management techniques and achieving cost efficiency in the execution of the medium term public debt management strategy.

During the year 2010, PDD effectively implemented the debt management strategy as approved by the Monetary Board in order to meet the borrowing requirements of the government. Accordingly, PDD used a mix of debt instruments depending on different market segments and investor appetite to raise debt within the approved borrowing limit. The relative sizes of foreign and domestic debt stock changed due to increase in foreign borrowings resulting from improved investor confidence bolstered by favourable macroeconomic developments in the country. PDD issued short, medium and long-term securities

(up to 10 year) during the year. In order to avail long-term securities in the market, a 10 year Treasury bond was issued in the background of a favourable interest rate scenario. In the latter part of the year, the third international sovereign bond of US dollar 1,000 million was issued. The upgrading of Sri Lanka's sovereign rating by the rating agencies assisted in raising debt at international market at a lower cost. During the year, PDD played an important role in facilitating the sovereign rating review process and functioned as the technical arm of the Sovereign Rating Committee. In addition, PDD raised US dollar 628 million from the domestic market through issue of Sri Lanka Development Bonds (SLDBs).

In order to ensure stability and smooth operation of the PD system, PDD continued off-site surveillance and on-site examinations of PDs during the year. PDD conducted meetings with the Chief Executive Officers (CEOs) of PDs on a monthly basis in order to strengthen the rapport with market participants, create an opportunity to discuss issues and developments in the market, communicate policies adopted and share views. In addition, during 2010, PDD provided PDs with opportunities to improve knowledge of the key personnel on the industry through various means, and these included an offshore study tour, seminars and workshops and meetings with international study groups.

In view of further strengthening the public debt management, PDD focused more on effective execution of debt management strategies in 2010. Consequently, the duration of the total debt portfolio increased from 4.20 years in 2009 to 4.31 years in 2010, the average time to maturity of the debt portfolio dropped from 5.29 years in 2009 to 5.25 years in 2010 however.

During the year 2010, PDD continued timely servicing of government debt (domestic and foreign debt) fostering the country's unblemished record of servicing debt obligations without a slightest default.

PDD took several steps during the year to provide up-to-date information to the market continuously with a view of improving credibility, accountability and

transparency in public debt management operations. Reiterating the importance of timely dissemination of information to develop a sound debt management system, PDD continuously updated CBSL website, and issued monthly data bulletin and its annual publication on public debt management in Sri Lanka.

In order to ensure that all transactions in government securities are timely and accurately recorded in the Central Depository System (CDS) maintained by CBSL, PDD closely monitored and supervised the records maintained at CDS. During the year 2010, PDD was able to expedite the issue of periodic statements to investors. With the view of developing a more competitive, dynamic and liquid securities market, PDD made several efforts during the year to broaden and diversify the investor base. PDD continued its programme to improve public awareness in investments in government securities.

## Developments in 2010

### (a) Borrowing Target and Strategy

In terms of the Appropriation Act No. 7 of 2010, the Parliament approved total gross borrowing limit of the government for 2010, amounted to Rs. 980.0 billion (book value). Of this amount, Rs. 685.3 billion was expected to be financed from the domestic sources while the balance Rs. 294.7 billion was expected to be mobilized through foreign sources. However, during the year, due to the increased investor confidence, a significant improvement in foreign fund inflow was observed and hence, borrowings from the foreign sources exceeded the expected level. Therefore, funds mobilized from the domestic sources reduced to Rs. 594.2 billion. The borrowings from foreign sources increased to Rs. 327.9 billion.

The outstanding foreign investments in rupee denominated government securities (Treasury bonds and Treasury bills) amounted to Rs. 240.9 billion (in face value) at end 2010 recording an increase of Rs. 55.3 billion during the year. Further, Sri Lanka's third international sovereign bond amounting to US dollar 1,000 million

(Rs. 111.8 billion) was issued in October, 2010 at a rate of 6.25 per cent with maturity of 10 years. By utilizing the relatively low cost funds from the sovereign bond issue, the government debt stock was restructured, retiring a significant portion of high cost short-term borrowings. The other foreign borrowings including funds mobilized through concessional sources (Project/Programme loans) in 2010 amounted to Rs. 163.9 billion.

Due to the expectations of high inflation that prevailed in the market during the first few months of the year, the interest rates moved upward. However, attributable to the monetary policy measures adopted to stimulate economic activities, lower inflation expectations of investors, foreign currency inflows through foreign investments on government securities, improved liquidity position in the market, and prudent debt management strategies adopted by PDD, the interest rates gradually moved downwards shifting the yield curve downward during the latter part of the year. Accordingly, secondary market yield rates on Treasury bills and Treasury bonds dropped by a range from 37 to 268 bps over the yield curve of 3 month to 6 year maturities during the year.

Owing to the high interest rate expectation that prevailed during the first few months, investors were reluctant to invest in medium to long-term domestic debt instruments and hence funds raised through short-term domestic debt instruments increased in 2010. Accordingly, funds mobilised through Treasury bills increased to Rs. 82.8 billion in 2010. However, due to the favourable developments during the latter part of the year, PDD was able to issue Treasury bonds to the value of Rs. 433.6 billion with medium to long-term maturities. In addition, US dollar 628 million (Rs. 71.2 billion) was borrowed through issue of SLDBs in 2010. Continuing the policy of reducing the non-tradeable debt stock from the domestic debt portfolio, PDD refrained from issuing Rupee Loans during 2010 as well.

In 2010, PDD continued its borrowing strategy to ease the monthly bunching pressure by limiting

the issue of 91-day and 182-day Treasury bills and increasing the value of issuance of 364-day Treasury bills. Accordingly, issue of 91-day Treasury bills reduced to 19 per cent of the total Treasury bill issues in 2010 from 21 per cent in 2009. Issue of 182-day Treasury bills reduced slightly to 34.5 per cent from 35 per cent in 2009. The share of 364-day Treasury bills in the issues in 2010 increased to 46.3 per cent from 43.6 per cent in 2009. With the high inflation expectation that prevailed in the market during the first few months of 2010, the execution of the borrowing strategy of issuing more Treasury bonds with medium to long-term maturities was a challenge during the first half of the year. However, favourable developments in the latter part of the year enabled PDD to issue longer term bonds with maturities of 5 years and above increasing the share of those bonds in the new Treasury bonds issues in 2010 to 37.9 per cent compared to 33.5 per cent in 2009. Further, PDD activated a long-term benchmark yield curve up to 10 years, by issuing Treasury bonds with 8-year and 10-year maturities in August and September 2010.

#### **(b) Use of Debt Instruments**

As in the previous year, issuance of Treasury bills and Treasury bonds was done through both auctions and private placements. Treasury bills amounting to Rs. 1,000 billion (face value) were issued during 2010. Of this total, Treasury bills of Rs. 910 billion were reissues, while the balance Rs. 90 billion was new issues. There were 53 Treasury bill auctions during the year through which Rs. 520 billion was mobilized, while Rs. 346 billion was raised through direct placements. The foreign participation in the Treasury bill programme on net basis amounted to Rs. 17 billion.

In the Treasury bond programme, total funds mobilized in 2010 amounted to Rs. 509 billion (face value), consisting of Rs. 46 billion mobilized through 17 Treasury bond auctions and Rs. 462 billion mobilized through direct placements of Treasury bonds. The foreign participation in the

Treasury bond programme on net basis amounted to Rs. 38 billion during the year.

PDD also conducted 3 SLDB auctions and made private placements of SLDBs to facilitate redemption of maturing SLDBs. The total amount of funds mobilized through the auctions and private placements of SLDBs amounted to US dollar 628 million. These funds were raised with maturity periods of two and three years at interest rates of six month LIBOR plus a spread ranging from 350 bps to 395 bps.

In order to ease the pressure on the domestic market, diversify the debt portfolio, and to enjoy the benefit of low interest rates in international markets, a 10 year international sovereign bond for US dollar 1,000 million was issued at a 6.25 per cent fixed coupon rate. The positive economic outlook consequent mainly to the ending of the internal conflict and upgrading of Sri Lanka's sovereign rating by the rating agencies, and the commitment of PDD to reduce the cost of borrowings, contributed to achieve a low interest rate of 6.25 per cent compared to the first and second international sovereign bonds issued with 5 year maturity and interest rates of 8.40 per cent and 7.25 per cent respectively, in 2007 and 2009.

#### **(c) Debt Service Payments**

During the year 2010, PDD serviced both foreign and domestic debt obligations of the government amounting to Rs. 820 billion. Out of the total debt serviced, Rs. 352 billion was for the payment of interest while Rs. 468 billion was for the principal repayments. Total payments in respect of domestic loans in 2010 amounted to Rs. 687 billion while the foreign debt servicing amounted to Rs. 133 billion (US dollar 1,197 million). In addition, maturing Treasury bills amounting to Rs. 844 billion were re-issued during the year.

Besides the routine debt servicing function, for the second consecutive year, PDD had to undertake a comprehensive management audit to streamline

the debt servicing functions. The audit findings were communicated to the External Resources Department of the Ministry of Finance.

**(d) Yield Rates and Secondary Market Performance**

Yield rates on Treasury bills and Treasury bonds fell by 37 to 268 bps across the yield curve of 3 months to 6 year maturities during the year. This was in line with the monetary policy stance of CBSL in response to emerging macroeconomic conditions. The shorter end of the yield curve, i.e., 3 months to 1 year yields, dropped by 37 to 179 bps while 2 year yield fell by 268 bps to 8.23 per cent, 4 year yield fell by 213 bps to 9.39 per cent, 6 year yield fell by 262 bps to 9.40 per cent, by end 2010. Accordingly, PDD could issue a new 10-year Treasury bond series at a yield of 9.30 per cent per annum.

Both Treasury bill and Treasury bond transactions increased significantly during 2010. The turnover ratio of these government securities in the secondary market increased to 22.5 times of the average government securities stock from 16.1 times in 2009. The increase was mainly due to the increase in secondary market outright and repo transactions during 2010 compared to 2009.

**(e) Scripless Securities Settlement System (SSSS) and the Central Depository System (CDS) - LankaSecure**

During 2010, PDD maintained the operations of LankaSecure with its participants consisting of 22 licensed commercial banks (LCBs), 6 non-bank primary dealers, and 2 non-dealer direct participants. The face value of securities transacted through SSSS increased by 60.2 per cent to Rs. 52.4 trillion. The number of accounts maintained at CDS increased by 13.5 per cent from 64,680 at end 2009 to 73,396 at end 2010. The LankaSecure continued to issue three kinds of statements: *Transaction Summary*, *Payment Statements* and the *Statement of Holdings*, to the investors in government securities. The Transaction Summary was generally issued

within the first week of the following month while the Payment Statement was issued within one week after paying the maturity proceeds / interest and the Statement of Holdings was issued within three weeks after every 6 months. During the year, 116,962 Transaction Summaries, 69,847 Payment Statements, and 51,701 Statements of Holdings were sent to the individual investors.

The total value of scripless securities recorded in the LankaSecure as at end 2010 amounted to Rs. 2,399.2 billion. These scripless securities consisted of scripless Treasury bills amounting to Rs. 571.8 billion and scripless Treasury bonds amounting to Rs. 1,827.4 billion.

Many improvements to LankaSecure business functionality were incorporated in 2010. The participant managed Intraday Liquidity Facility (ILF) and the auto-reversal facility for customer Repurchase (Repo) transactions can be highlighted as two major improvements. The participant managed ILF enabled the Treasurers of the participating institutions (LCBs and PDs) to carry out multiple ILF requests and reversals during the operating schedule of the business day as and when liquidity is required by their financial institutions, to discharge their payment obligations to other participating financial institutions. The auto-reversal facility for customer Repo transactions removed the manual intervention required to reverse a customer Repo transaction at its maturity.

**(f) Supervision of Primary Dealers**

PDD continued the supervision of PDs in 2010, through on-site examinations and off-site surveillance, with the view of maintaining the stability and credible operations of the PD system. Accordingly, three comprehensive on-site examinations and two spot on-site examinations were conducted during the year, focusing on the exposure of PDs to risks, including market risk, liquidity risk and operations risk in carrying out their operations. Apart from on-site examinations, continuous off-site surveillance based on weekly

and monthly reporting of PDs was carried out on the operations of each PD.

PDD conducted 8 meetings with Chief Executive Officers (CEOs) of PDs as a direct communication link between PDD and the market participants, where information regarding latest developments in the economy and in the domestic market as well as in the international markets were communicated to CEOs. Financial performance of PDs, in aggregate form, was also presented to CEOs, and any adverse developments or trends observed in the financial indicators were discussed in general.

In addition to the supervisory activities, knowledge building activities for the market participants were also carried out during 2010. In order to enhance knowledge in policies and systems adopted in developed debt markets, a study tour to Australia was organized for CEOs of PDs in March 2010. During the study tour, CEOs visited a number of government agencies including the Reserve Bank of Australia, the Australian Office of Financial Management (the Debt Office) and the Australian Securities Exchange. They also visited the Financial Market Association and certain market participants in debt and capital markets. In May 2010, a workshop was organized targeting the dealers and treasury officials of PDs to give them a deeper understanding of the developments in the economy and in the domestic and international markets. The Role of a Primary Dealer in Government Securities was also highlighted at the workshop.

During the year, PDD hosted three international study groups from the Bank of Ghana, Government of Kenya and Bangladesh, on the operations of the government securities market and the Primary Dealer System in Sri Lanka.

#### **(g) Government Securities Market Development**

Recognizing the importance of developing the government securities market and expanding the investor base for government securities, PDD continued its island-wide investor awareness

programmes. During the year, PDD conducted 18 public investor awareness programmes, 61 radio programmes jointly with Ruhunu Sevaya, Rajarata Sevaya and Kandurata Sevaya, 2 educational programmes, and 12 television discussions. In addition, PDD participated in the 'Dayata Kirula Exhibition' to improve knowledge of the general public and school children in investments in government securities.

With the view of developing the secondary market for government securities, PDD explored the possibilities to re-introduce an e-trading platform for secondary market trading. As the first step for this purpose, a seminar was organized by PDD with the assistance of Bloomberg to educate CEOs and treasury staff of PDs and LCBs on the benefits and operations of an e-trading platform.

## **22. REGIONAL DEVELOPMENT**

The Regional Development Department (RDD) continued to engage in coordinating and facilitating credit delivery in the agriculture, livestock and micro small & medium sector enterprise (MSME) sectors during the year 2010, with a view to ensure availability of finance for development through Participating Financial Institutions (PFIs) under donor funded or government sponsored development credit programmes, initiated/introduced by the Government of Sri Lanka (GOSL) and the Central Bank of Sri Lanka (CBSL). RDD actively involved in credit delivery through PFIs in the regions in order to achieve the following objectives.

- (a) Enhancement of regional growth through facilitating investments in the potential economic activities in the regions.
- (b) Reduction of poverty by addressing poverty related issues and promoting financial inclusiveness among the low-income people in the regions.
- (c) Generation of employment among the educated youth, unemployed women and self-employed by facilitating them to obtain finance from the formal financial sector and to acquire required knowledge and technical skills to develop their own businesses.

- (d) Resumption of business and economic activities in the regions that are affected by natural or man-made disasters.
- (e) Enhancement of production of essential food items to ensure food security of the people through self-sufficiency.

During 2010, RDD implemented and coordinated the under-mentioned loan schemes by provisioning of refinance or interest subsidies and at the instances where necessary, ensuring credit supplementary services to PFI.

### 22.1 Development of Conflict Affected Regions

During the year under review, RDD focused on the development related issues in the Northern and Eastern provinces that were adversely affected by long drawn conflict. The conflict has hindered the growth prospects of the two provinces since 1980s. Subsequent to the liberalization, RDD introduced special loan schemes for the two provinces i.e. "Awakening North" and "Rising East" with a view to boost the livelihood development of the people and assist Internally Displaced Persons (IDPs) to commence their livelihood and economic activities after resettlement. The two loan schemes provided financial assistance for the resumption of economic activities in agriculture, livestock, fisheries, micro and small enterprises and trade and other self-employment projects in the provinces. Under the "Awakening North" loan scheme 9,108 loans amounting to Rs. 1,240 million have been granted by the PFIs. The highest number (2,938) and value (Rs. 460 million) of loans were received by trade and self-employment activities while 2,526 loans amounting to Rs. 322 million were received by agriculture and related activities. Livestock sector activities received 2,001 loans amounting Rs. 226 million while micro business (954 loans) and fisheries sector activities (689 loans) received Rs. 150 million and Rs. 84 million, respectively. Under the "Rising East", PFIs have granted Rs. 752 million for 5,155 beneficiaries. The highest number of loans (2,755) and value of loans (Rs. 433 million) were received by trade, tourism and other self-employment activities followed by perennial crops (1,660 loans worth of Rs. 235 million), livestock development (610

loans valued Rs. 70 million) and fisheries and related activities (Rs. 13 million for 127 loans) in the Eastern Province.

With the peaceful atmosphere that prevailed during the year, the other development loan schemes have also been implemented actively in the two provinces. RDD also targeted to reach poor households in the two provinces under the Poverty Alleviation Micro-finance Project (Prabodini) with the assistance of PFIs during the year. The number of beneficiaries enrolled under Prabodini in the Eastern province was reported at 10,302 as at the end 2009. Of these, 5,837 beneficiaries were granted micro loans to a total value of Rs. 258 million. In the Northern province, the Prabodini enrolled 8,573 applicants of which, 3,193 beneficiaries received loans to the value of Rs. 158 million. In addition, the two new schemes introduced in 2010, Saubagya and Self-Employment Initiative Loan Scheme, provided facilities for the eligible beneficiaries in the two Provinces.

RDD also participated in a social development programme in which 378 conflict affected IDPs in the Eastern province were benefited. For this project, funds were drawn from Bank of Ceylon and Peoples Bank under their Corporate Social Responsibility Programme. It was a joint effort to support selected beneficiaries under the Prabodini to repair damaged houses of resettled IDPs and reactivate their livelihood activities with the support of formal sector institutions i.e. Bank of Ceylon, Peoples Bank, Divisional Secretariat, Sri Lanka Army, Special Task Force (Sri Lanka Police) and Sarvodaya movement. The success of the programme clearly illustrated that participating methodology could be replicable in other areas too for construction of damaged human habitats at a minimum cost with community participation.

### 22.2 Region Specific Development Programmes

In addition to the Northern and Eastern provinces, RDD also implemented region specific loan schemes in the other districts with a view of uplifting living conditions of the people by promoting income-generating activities in those districts. Accordingly, Dry



**Table II - 15**  
**REGIONAL DEVELOPMENT LENDING PROGRAMMES**  
**IMPLEMENTED BY THE REGIONAL DEVELOPMENT DEPARTMENT**

	Project and Implementation Period	Source of Funds	Broad Mission	Fund Allocation	Annual Interest Rate to Borrowers	Recovery Rate where applicable
1	<b>Agriculture and Animal Husbandry</b>					
1.1	Second Perennial Crops Development Project Revolving Fund (SPCDPRF) 2006-2014	Government of Sri Lanka (GOSL)	Commercialization of Perennial Crop Sector, increasing production, nursery development, post-harvest handling and processing activities and marketing.	Rs. 1.2 billion	9%	Around 92%
1.2	Tea Development Project (Revolving Fund) - (TDRPF) 2006-2018	GOSL	Increasing tea small holders' income on a sustainable basis and developing the necessary infrastructure required for meeting the requirements of the export market. In this connection, assistance is available basically to modernize tea factories to acquire HACCP certification.	Rs.1.1 billion	9%	Around 92%
1.3	New Comprehensive Rural Credit Scheme - (NCRCS) (Continuous Programme)	PFI's own funds and Government Interest Subsidy	Provision of the working capital requirement of small farmers <ul style="list-style-type: none"> <li>• Short-term production loans</li> <li>• Production of seeds and plant material</li> <li>• Purchase of agricultural commodities under Forward Sales Contracts</li> </ul>	Loans granted by PFI's using their own funds. Rs. 3.6 billion in 2010	8%	Between 90 – 95%
1.4	Agro-Livestock Development Project	PFI's own funds and Government Subsidy	In dairy farming, provision of capital for <ul style="list-style-type: none"> <li>• Construction of cattle sheds</li> <li>• Purchase of cows</li> <li>• Purchase of concentration feed, veterinary services &amp; drugs, etc.</li> <li>• Cultivation of animal fodder</li> <li>• Construction of bio-gas units</li> <li>• Any other requirements recommended by Veterinary surgeons</li> </ul> In Liquid Milk Processing Industries and Agro-based Industries, provision of funds for; <ul style="list-style-type: none"> <li>• Construction of industrial buildings/ Modernization</li> <li>• Purchase of modern machinery and equipment</li> <li>• Storage, cold rooms and transport services, other required services, purchase of equipment for maintenance of standards</li> </ul>	Loans granted by PFI's using their own funds. Total fund delivery is expected to be Rs. 5,000 million	For small dairy project loans-8%  For milk and crop processing-12%	90%
1.5	Krushi Navodaya Scheme	PFI's own funds and Government Interest Subsidy	Provision of medium term loans for activities in agriculture and animal husbandry including agro related industry and micro and drip irrigation.	Loans granted by PFI's using their own funds. Total fund delivery during operational period expected to be Rs. 3,000 million	14%	Approximately 90%

2	<b>Small and Medium Enterprises Sector</b>					
2.1	Matale Regional Economic Advancement Project (Revolving Fund) - (MREAPRF) (2007-2009)	IFAD	Raising the income of rural and farm families by providing funds for small and medium scale enterprises in the District.	Rs. 77 million	10%	90%
2.2	Sabaragamuwa Province Integrated Rural Development Project (Revolving Fund) - (SPIRDPRF) (2007-2010)	GOSL	Upliftment of the living conditions of the people in the project area by promoting income-generating activities.	Rs. 100 million	10%	93%
2.3	Post-Tsunami Line of Credit – EIB Contract B Loan Scheme (2006-2014)	EIB	To assist the affected small and medium scale enterprises for resumption of business in the Tsunami affected districts.	EURO 10 million	9%	92%
2.4	Sushana Loan Scheme (Phase II)	CBSL	To assist micro, small and medium scale enterprises affected by the Tsunami to resume business.	Rs. 500 million	6%	90%
2.5	Construction Sector Development Project (2007-2015)	AFD	Financing the purchase of machinery by companies rated by the Institute of Construction, Trade and Development for post-Tsunami reconstruction activities.	EURO 9 million	9%	Over 95%
2.6	Awakening North special refinance loan scheme	CBSL	To assist IDPs and others settled in the Northern Province to restart their economic Activities.	Rs. 3 billion	9%	Within the Grace Period
2.7	Revolving Fund for Development of Eastern Province “Rising East”	CBSL	Resumption of economic activities in the Eastern Province.	Rs. 1 billion	9%	Within the Grace Period
2.8	Saubagya Loan Scheme	CBSL/RDD	To start up, expand any micro, small and medium enterprise (MSME) or any MSME affected by disaster.	Initially Rs. 500 million	9%-10%	Within the Grace Period
2.9	Self Employment Initiative Loan Scheme	GOSL	To provide financial assistance trained youth who passed out from recognized vocational training institutions in the country.	Rs. 100 million	10%	Within the Grace Period
3.	<b>Micro Finance Sector</b>					
3.1	Dry Zone Livelihood Support and Partnership Programme (2006-2012)	IFAD	Poverty alleviation and income generation among the poor farmers in the selected districts i.e. Monaragala, Kurunegala, Badulla and Anuradhapura.	Rs. 221 million	10%	Over 90%
3.2	Small Holder Plantation Entrepreneurship Development Programme (2007-2015)	IFAD and USAID	Improving the livelihoods of marginalized small holders who are producing tea and other perennial crops in the mid-country region and poor upland food crop farmers in the intermediate zone of Monaragala district wishing to take up rubber cultivation.	SDR 15.25 million	9%	Within the Grace Period
3.3	Small Farmers & Landless Credit Project Revolving Fund	GOSL	Setting up of an effective credit delivery mechanism for channelling formal credit to income generating activities for the rural poor to improve the economic conditions and general welfare of the beneficiaries.	Rs. 328 million	16%-20%	Over 90%
3.4	Poverty Alleviation Micro-finance Project (Revolving Fund) PAMP (RF) Scheme 2009-2013	GOSL	Poverty eradication through promotion of income generating activities among them. Organizing low-income groups to link them with formal banking system.	Rs. 2,010 million	12%	Over 90%
3.5	Poverty Alleviation Microfinance Project II (PAMP II)	GOSL JICA	-do-	JPY 2,100 million	15.5% maximum	Within the Grace Period

Zone Livelihood Support and Partnership Programme, "Bagya", (Monaragala, Kurunegala, Badulla and Anuradhapura Districts), Small Holder Plantation Entrepreneurship Development Programme (mid-country region and intermediate zone of Monaragala district), Matale Regional Economic Advancement Project and Sabaragamuwa Province Integrated Rural Development Project were implemented in the year under review.

### 22.3 Agriculture and Animal Husbandry Sector

RDD continued to operate the Agro-Livestock Development Loan Scheme (ALDL), which was mainly aimed at promoting liquid milk production in the country, and provided loans for eligible buyers during the year. In addition to dairy farmers, medium scale investors in the private sector were also eligible to obtain finance facilities for construction of stores/factories, etc. purchase of machinery, equipment for liquid milk processing plants and agro-processing industries. During the year, PFIs were able to grant Rs. 442 million among eligible recipients under the scheme. With a view to promoting the best practices among the dairy farmers, the RDD published a handbook on dairy management. Further, five Dairy Resources Centres were opened at Horana, Madampe, Gampaha, Kekirawa and Kurunegala to facilitate farmers for purchasing and selling of their milch cows.

New Comprehensive Rural Credit Scheme (NCRCS) continued the operations to provide facilities to farmers for cultivation of agricultural crops during 2010. In Maha 2009/10, Rs. 2,016 million has been granted among 41,950 farmers which was a 5.3 per cent increase over that of the corresponding cultivation season of the previous year. In Yala season, the amount of loans granted for cultivation increased by 55 per cent, over that of the season in the previous year to Rs. 1,568 million. The increase in loan disbursement was reflected in cultivated land area of paddy and other crops. Paddy represents over 60 per cent of the loans provided under the NCRCS while the balance was shared amongst maize, potato, onion and other field crops. Polonnaruwa, Anuradhapura, Jaffna and Hambantota districts received the highest number and amount of agricultural loans under NCRCS.

Meanwhile, under the Krushi Navodaya scheme, PFIs have granted medium and long-term credit to micro and small enterprises for agriculture related activities with interest subsidy support from the government. A fair quantum of loans under Krushi Navodaya has been distributed in the Northern and Eastern provinces during the year.

### 22.4 Promoting SME Financing and Employment Generation

In 2010, RDD introduced a new loan scheme under the name of Saubagya (Prosperity) for the purpose of providing credit facilities for micro, small and medium scale enterprises (MSMEs) and MSMEs affected by disasters in the Island. This scheme, encompassing the entire island, provides loans up to a maximum of Rs. 500,000 for start-up MSMEs while granting up to Rs. 20 million per disaster affected MSME. The RDD provides refinance for 100 per cent of the loan amount disbursed by the PFIs subject to the above upper limits. In 2010, RDD introduced the Self Employment Initiative (SEPI) loan scheme, for promotion of self-employment among vocationally qualified youth with the assistance of Ministry of Finance and Planning and Ministry of Vocational and Technical Training. Accordingly, the scheme provides financial assistance for trained youth who passed out from recognized vocational training institutions in the country for establishment of their own self-employment projects.

Apart from the newly introduced schemes, the other schemes that aimed at SME promotion and employment generation also operated among the target population during 2010. Loan disbursement under the Construction Sector Development Project (CSDP) progressed satisfactorily during the year by granting loans to the value of Rs. 268 million while Rs. 87 million were granted under EIB Post Tsunami (Contract B) Line of Credit during the year. The Sabaragamuwa Integrated Rural Development Project (Revolving Fund) (SIRD-RF) scheme and the Matale Regional Economic Advancement Programme (Revolving Fund) Scheme (MREAP-RF) also continued to operate in the relevant districts in 2010. Under SPIRDP-RF, refinance was released in respect of loans amounting to a total value of Rs. 42 million during the

year while under MREAP-RF, refinance amounting to Rs 54.9 million was released to PFLs.

### 22.5 Poverty Alleviation and Employment Generation

Poverty Alleviation Micro-finance Project (Prabodini) funded by Japan International Cooperation Agency (JICA) continued to operate in 14 selected districts in the country in 2010. The objective of this project is to improve income level of the poor and enhance an inclusive formal financial service for them by providing credit for income generating activities and training for skill development, thereby contributing to alleviate poverty, mitigating regional inequity and supporting peace building. The number of beneficiaries enrolled under the Prabodini during the year was reported as 40,384. Out of these, 19,860 beneficiaries had been granted loans to the value of Rs. 865 million to commence income generating activities, an increase of 17 per cent over the amount of loans granted in the previous year.

Meanwhile, the Small Farmer and Landless Credit Project Revolving Fund (SFLCP), that intends to improve economic conditions and general welfare of the rural poor, also progressed in 2010 by granting of loans (among 5,753 beneficiaries) to the value of Rs. 140 million. The Dry Zone Livelihood Support and Partnership Programme, which aimed at improving the livelihoods of marginalized small holders and poor upland food crop farmers in Aanuradhapura, Badulla, Monaragala and Kurunegala districts distributed Rs. 47 million among 909 beneficiaries.

### 22.6 Credit Supplementation

The RDD continued to operate credit supplementation schemes and engaged in collection of annual premia, processing of claim applications, payment or rejection of claims and follow-up post claim recoveries under 12 credit supplementation schemes during the year 2010. The total premia collected in 2010 was Rs. 53 million while total payment of credit guarantee claims was reported as Rs. 184 million during the year.

The RDD introduced a new credit guarantee scheme for the benefit of farming community in the Northern

province. The new Credit Guarantee scheme will facilitate PFLs to grant loans for short-term crop cultivation undertaken by the farmers in the Northern province. The objective of this guarantee scheme is to ensure credit flow to farmers in Mullaitivu, Killinochchi and Mannar districts who experience difficulties in obtaining loans for cultivation purposes, because they are unable to establish land ownership since the title deeds and other documents were lost or destroyed during the conflict. This guarantee scheme compensates the PFLs, which accept lands as collateral in the above districts, in the instances where it is found that the borrower does not in fact enjoy the ownership of the land.

## 23. SECRETARIAT

In 2010, Secretariat Department (SD) facilitated efficient functioning of the CBSL through timely procurement of goods and services, continuous assessments and upgrading of the operational systems and procedures, administering and implementing rules and regulations in respect of leave, superannuation funds, local and foreign travel.

The SD procured capital and non-capital goods and services amounting to Rs. 208.9 million, mainly through tenders by assuring and maintaining quality, timeliness, and competitive prices. As usual, procurement planning was continued further to monitor the procurement management process of the CBSL in order to streamline the timely supply of goods and services to the user departments. As a result, the SD was able to complete 92 per cent of the total procurement requirements of the Bank successfully during the year. In addition, the SD obtained a cost effective and comprehensive insurance cover for all CBSL properties. The Central Bank Pension Scheme, Widows' and Orphans' Pension Fund (W & OP) and Widowers' and Orphans' Pension Fund (WR & OP) were administered by the SD. A total of 1987 pensioners are enrolled under these schemes and the automation of existing database for these schemes was completed with the development of a software programme to enhance the efficiency of the release of pension fund.

During the year 2010, SD continued to provide the Bank with legal services. Such services were made

available in a wide array of activities ranging from routine legal issues to policy formulation so as to catalyze the activities of the Bank.

In handling litigation, a proactive role was played to assert and defend the rights of the Bank. In order to facilitate smooth handling of diverse challenges before the Bank, necessary assistance was provided by preparing suitable laws and by-laws in respect of the banking and financial sector.

In 2010, the SD coordinated and organized various religious and commemorative events and annual ceremonies such as long service award ceremony and Independence Day ceremony.

## 24. SECURITY SERVICES

Security Services Department (SSD) continued to strengthen the security of the Central Bank of Sri Lanka (CBSL) with the co-operation of the security forces and Police to protect its employees, buildings, properties, visitors and currency consignment in transit. A new automated Visitor Monitoring and Management System was introduced to ensure that all visitors and incoming material are checked and cleared efficiently within three minutes. Fifteen new security personnel on outsourced basis were employed to provide security to the newly established Provincial Offices in Jaffna and Trincomalee. Actions were initiated to review and update the centralized integrated security system (turnstile attendance system and door access system) at Head Office, CBSL. A new CCTV Camera and Recording System was installed at the Centre for Banking Studies, Rajagiriya in parallel with the programme to uplift the Centre for Banking Studies into an international training centre.

During the year, 02 new staff grade officers with military background were recruited to the SSD for better and efficient governance of the department. Two Staff Officers were sent to Malaysia for two week overseas training on advance security management with a view to update latest commercial security knowledge. Further, 11 Staff Officers and 184 Non-Staff Officers attended various workshops conducted locally pertaining to security and office management.

Fire wardens selected from different departments and provincial offices of CBSL were given a two day comprehensive training on fire fighting, fire preventing and first aid and also successfully conducted the annual practical fire fighting and training session for all employees of the CBSL with the assistance of the Air Force, Colombo Fire Brigade and St. Jones Ambulance.

Sri Lanka Army conducted weapon and live firing programme for all security officers of the CBSL during the year 2010. SSD also took part in all drills held on testing the Business Continuity Plan for critical operations of the CBSL. With all these, SSD managed to maintain another successful year without any security breach.

## 25. STATISTICS AND FIELD SURVEYS

In 2010, the Statistics Department (STD) accomplished its operations of collection, compilation, analysis and dissemination of data on national accounts, prices, wages, labour force employment, and other socio-economic sectors as well. STD released socio-economic data and information regularly to the general public through the publication of weekly and monthly selected economic indicators in the press and Central Bank website, and through the issuing of regular monthly press release on the behaviour of the consumer price index.

In addition, during the year under reference, the Department's senior staff participated as resource persons at several awareness programmes and training programmes organized by CBSL. With a view to improving overall productivity, the Department continued training its officers and many Staff Class Officers and Non-Staff Class Officers underwent local and foreign training, during the year.

### 25.1 Statistical Surveys

The monthly Inflation Expectation Survey which was initiated in end 2006 was continued. It covered a sample of around 300 respondents and their responses were collected through different means such as work-site interviews and e-mails. The results of each month's survey were submitted to the Monetary Policy Committee (MPC) and the Monetary Policy

Consultative Committee (MPCC) at their monthly meeting in the subsequent month. The land price survey, which was initiated in 2006 too was continued, and a Land Price Index was also computed using data from the Valuation Department.

In addition, STD conducted a sample survey in the District of Jaffna. The objective of the survey was to collect comprehensive information on living conditions, labour market situation, household activities and aspiration. The sample comprised 600 households drawn from the urban and rural sectors of the District of Jaffna. Also, the information was collected on respondent perceptions on changes in socio-economic conditions and living standards since the end of the conflict.

Preliminary work for the proposed Consumer Finances and Socio Economic Survey (CFSES) 2011/12 was also commenced during the year. This survey is expected to cover the whole Island including the Northern Province and will be the first CFSES to do so after 1981/82. The other major task completed during the year was the compilation of a revised Prosperity Index to measure prosperity in Sri Lanka and the provinces.

## 25.2 Improving Doing Business Ranking

In 2010, the Department undertook a special project for improving the 'Ease of Doing Business Ranking' in Sri Lanka. For this purpose, the department initially organized a high level seminar during the year for Secretaries of Ministries and high officials to map out a strategy to improve Sri Lanka's ranking. An information booklet titled 'A Step by Step Guide to Doing Business in Sri Lanka' was also published by the department during the year. It could be used as a single source document by prospective investors to understand the multitude of requirements to be fulfilled and regulations that have to be adhered to by the respective entrepreneurs in setting up and operating a business.

## 25.3 Country-Wide Data Collection System

The Country-Wide Data Collection System (CWDCS), which commenced in 1978, was continued with regular collection of information on retail prices of consumer

goods, producer prices of agricultural commodities and informal sector wages. Data were collected through government school teachers, who were hired as statistical investigators for 102 data collection centres in operation island-wide, including 18 centres in the Northern and Eastern provinces. Data collected under the system are extensively used for compilation of price indices, projection of the price movements for policy decisions, evaluation of the impact of policy changes on prices and estimation of national expenditure and income. Data were also useful for analysing seasonal variations, volatility and regional differences in prices and wages. The accuracy of data collection was ensured through regular field supervision of centres according to an annual programme set at the beginning of the year. Supervision activities of selected data collection centres were decentralized and assigned to the respective Provincial Offices of CBSL with a view to further strengthening CWDCS.

A symposium for all teacher investigators across the country was conducted in January 2010 with a view to placing on record the appreciations of the valuable service rendered by teacher investigators in the operation of the programme which completed 31 years from its inception in 1978. This provided an opportunity to discuss the common issues and share views of common interest relating to operation of the programme in a single forum. Further, Tamil speaking teacher investigators in the Northern and Eastern provinces, who were deprived of such opportunity due to the civil conflict conditions that prevailed in these areas during the last few years, also had an opportunity to share their experiences. In addition, three regional seminars were conducted in Matara, Anuradhapura and Kandy in 2010 in order to provide further training for the data collectors to improve the accuracy, quality, efficiency and timeliness of their data collection. The discussion sessions at these seminars were focused mainly on post-conflict developments in the country and their impact on prices and wages. Further, special awareness sessions were also conducted in the areas such as, issue of Sovereign Bonds, price level and movement of inflation, and inflation expectation survey, etc. The effectiveness of such programmes was reflected by the improved awareness and the enthusiasm shown by the teacher investigators. It was also decided to

use CWDCS in the future as part of an early-warning system on production/price developments in order to give fine tune inflation projections.

#### 25.4 Prices, Wages, Employment and Productivity

STD continued with the analysing of movements of consumer prices based on the Colombo Consumers' Price Index (2002=100) compiled by the Department of Census and Statistics (DCS) and issuing a monthly press release on the same. Analytical reports on price developments were also prepared to facilitate macroeconomic management. Projections for short-term and medium term inflation were prepared by STD to be used as leading indicators of the future direction of price movements. In 2010, in order to make projections sensitive to contemporary price developments in specific items and tariff changes, spread sheet projections of CCPI were also prepared. During the year, the department had several meetings with DCS to discuss the progress and issues of the proposed scheme for rebasing CCPI, based on the consumer expenditure pattern as reflected by the Household Income and Expenditure Survey conducted in 2006/07 by DCS.

STD continued to compile provincial consumer price indices based on the Consumer Finances and Socio Economic Survey (CFS) of 2003/04 with a view to meeting the need of policy formulation at the provincial level in the context of provincial development. In addition, a composite CPI covering the entire country based on the CFS of 2003/04, which reflects the movement of the price level at national level continued to be compiled by STD. The prices necessary for the compilation of these indices were mainly collected through CWDCS.

The Department also compiled informal sector wages for Sri Lanka, based on CWDCS wage data. The sub-sectors covered for collection of wage information under the scheme included paddy, tea, rubber and coconut cultivation, small-scale industry, construction and services. In addition, wage rate indices for the public sector which cover the non-executive grades and minor employee grades in the central government and the government school teachers were also compiled

and analysed by STD. Wages in the formal private sector were monitored by STD through the minimum wage rate indices computed by the Department of Labour for agriculture, industry and commerce and service sectors.

Meanwhile, STD continued with compiling the Wholesale Price Index to analyse movements in prices at the primary market level. A study was carried out in 2010 to examine the feasibility of revising the current WPI or switching over to a Producer Price Index (PPI) following the international practices in order to address the main deficiencies of the prevailing WPI. Data collection work pertaining to producing a PPI commenced in 2010.

STD continued to conduct Annual and Quarterly Public Sector Employment Surveys (QPSES), which were initiated by STD in 2001, with a view to finding the levels and trends in public sector employment in the country. These data were also used to estimate quarterly national income estimates. The quarterly survey covered all Central Government, Local Government and Semi-government institutions with over 1,000 employees each as reported in the Annual Public Sector Employment Surveys (APSES) of 2009, excluding those under Provincial Councils. The information collected in these surveys helps to assess the effectiveness of the current employment policy of the government and serves as a measure of improving productivity and efficiency in the public sector. Information collected on labour force and labour market was also analysed by STD covering the areas of foreign employment, labour relations and labour market reforms, and labour productivity.

#### 25.5 National and Regional Income

STD continued to monitor the developments in the real sector of the economy and to compile the relevant projections of national income. This included collection of primary and secondary data, analysis of developments in the economy and forecasting future trends in production, consumption, savings and investments in the country.

The Department continued to liaise with DCS which bears the responsibility in compilation of official national income estimates for the country, enabling the flow of

information and thereby contributing immensely to the activities of both institutions.

As in the previous years the Department also compiled and analyzed the annual Gross Domestic Product disaggregated by province with a lag of one year for 2009. These statistics were made available to the public as a time series from 1996 to 2009. The series provide comprehensive statistics for policy makers in analyzing and identifying regional disparities in economic activities and growth performances in the country.

### 25.6 Dissemination of Statistics

During the year, STD released its two annual publications titled "Economic and Social Statistics of Sri Lanka 2010 – Volume XXXII" and "Sri Lanka Socio Economic Data 2010 – Volume XXXIII" in April and June 2010 respectively. In addition, the statistical tables in the pocket diary 2011 of CBSL were also updated. STD made its regular contributions to statutory and other publications of the Bank during the year. The Departmental Website on the local area network, StaNet, CBSL website were updated on a regular basis.

## 26. SUPERVISION OF NON-BANK FINANCIAL INSTITUTIONS

The Department of Supervision of Non-Bank Financial Institutions (SNBFI Dept.) was established, on 12.12.1988, to implement the provisions of the Finance Companies Act No. 78 of 1988 (FCA) which involve regulation and supervision of Registered Finance Companies (RFCs). The department's scope was further broadened with the enactment of the Finance Leasing Act, No.56 of 2000 (FLA), which provides for the regulation and supervision of finance leasing business. The supervisory responsibilities of the department include formulation and implementation of prudential requirements, conducting continuous supervision and periodic statutory examinations of institutions, granting specific approvals, resolution action on weak companies under supervision, investigation and legal action on conduct of finance business without permission and conduct of public

awareness programmes. As at end 2010, there were 37 Registered Finance Companies (RFCs) and 70 Registered Finance Leasing Establishments (RFLEs) comprised of 11 licensed commercial banks, 4 licensed specialised banks, 34 RFCs and 21 Specialised Leasing Companies (SLCs) in operation. The names of these RFCs and RFLEs are provided in Annex II-2.

### 26.1 Issue of Directions and Prudential Requirements

New prudential regulations and several amendments to existing regulations were introduced with the approval of the Monetary Board in 2010 which are summarised below. Details of the same are provided under Part III to the report.

#### (a) Regulations to RFCs

(i) **Revision of ceilings on rate of interest offered for deposits:** In view of ensuring interest rates offered were not beyond sustainable levels, maximum rates of interest that could be paid by RFCs on deposits were revised. For time deposits maturing in one year or less, the maximum rate was increased to 4 per cent plus the weighted average 364-day Treasury bills yield rate (WATBR) while for those maturing in longer periods it was reduced to 5.0 per cent plus WATBR. However, RFCs were allowed to offer additional interest of one percentage point above the stipulated ceiling to senior citizens.

(ii) **Introduction of the Sri Lanka Deposit Insurance Scheme:** In order to introduce a financial safety net measure and promote depositor-confidence, RFCs were required to insure deposit liabilities in the "Sri Lanka Deposit Insurance Scheme" implemented by the Monetary Board for licensed banks and RFCs under the provisions of the Monetary Law Act with effect from 1 October 2010. Under the scheme, compensation of deposits is up to a maximum of Rs. 200,000 per depositor in the event the licence/registration of a RFC is suspended or cancelled by the Monetary Board on or after 1 January 2012 and RFCs are required to pay an insurance premium of 0.15 per cent per annum payable on a monthly basis.



- (iii) **Increase in registration fee:** The licence fee payable at the year of first registration by an RFC was increased from Rs. 50,000 to Rs. 500,000. Further, annual license fee was increased from Rs. 50,000 to be as follows.

Total Assets of the RFC	Annual Licence Fee, Rs.
Rs. 1 billion or below	150,000
Above Rs. 1 billion up to Rs. 10 billion	250,000
Over Rs. 10 billion	500,000

- (iv) **All RFCs to be listed in Colombo Stock Exchange:** In order to improve transparency and accountability as well as to build public confidence, all RFCs thus far not listed in the Colombo Stock Exchange (CSE) were required to be listed by end of June 2011.

(b) **Regulations to RFLEs**

- (i) **Increase in minimum Core Capital of SLCs:** With a view to promoting the soundness and resilience, SLCs were required to maintain an unimpaired core capital not below the amounts as set out below.

Minimum Core Capital (Rs. mn)	Effective Date
100	From 01.01.2012
150	From 01.01.2013
200	From 01.01.2014
250	From 01.01.2015
300	From 01.01.2016

- (ii) **Increase in minimum paid up capital for a new SLC:** With a view to promoting the existence of strong non-bank financial institutions, the minimum issued and paid-up capital of a public company applying for licence under the FLA was increased as follows.

Minimum issued and paid up capital (Rs. mn)	Effective Date
100	From 01.01.2011
150	From 01.01.2012
200	From 01.01.2013
250	From 01.01.2014
300	From 01.01.2015

- (iii) **Submission of periodic returns to Central Bank:** In order to improve the quality of the continuous examinations and for monitoring of SLCs, all SLCs were required to submit financial statements along with returns on borrowings, accommodations, credit, maturity gap, etc. through the Central Bank's web based data transmission system on a monthly/ quarterly and annual basis.

- (iv) **Approval for opening/shifting/closure of branches/business places:** The opening/change of location/ closure of any branch/business place of an SLC was formalized requiring SLCs to obtain prior approval in writing from Director, SNBFI Dept. for any such activity.

- (v) **Increase in fee payable at application, first registration and annual renewal:** The fee payable at application for registration as an RFLE was set at Rs. 25,000 for a licensed commercial bank, licensed specialized bank or a finance company. For any other public company this fee was set to be Rs. 50,000. Upon successful application, the fee payable at first registration was set to be Rs. 250,000 and the subsequent annual fee to be payable based on the total assets of the RFLE was as follows.

Total Assets of the Establishment	Annual License Fee, Rs.
Rs. 1 billion or below	150,000
Above Rs. 1 billion but less or equal to Rs. 10 billion	250,000
Over Rs. 10 billion	500,000

## 26.2 Licensing of New Financial Institutions and Granting Regulatory Approvals

- (a) During 2010, two companies were registered under the FCA, increasing the total number of RFCs from 35 to 37. Approvals for 98 new branches were granted during the year, out of which 41 were to be located in the Northern and Eastern Provinces. Further, approvals were granted to RFCs to change their names i.e., Ceylinco Investment and Reality Ltd. as The Standard Credit Lanka Ltd., Nextfinance Ltd. as Kanrich Finance Ltd., Silverreen Finance Co. Ltd. as People's Merchant Finance Company Ltd. and Capital Reach Leasing PLC as Softlogic Finance PLC.
- (b) Meanwhile with the merger of 4 Licensed Specialized Banks, the total number of RFLs declined to 70 by the end of the year. However, 44 new branches of SLCs were opened country-wide with 15 in Northern and Eastern Provinces.

## 26.3 Continuous Supervision of Financial Institutions

Off-site surveillance was carried out by analysing financial information received through periodic returns submitted by RFCs and SLCs. Such analysis provides a basis for identifying early warnings on adverse conditions of these institutions that need further examination and corrective action. Where necessary, meetings with Boards of Directors, senior management and auditors were also held to resolve any adverse situations. The Governor's meetings with the CEOs of RFCs and SLCs were conducted on a quarterly basis in the interest of strengthening the RFCs and SLCs sectors. The major items discussed at these meetings inter alia were overcoming liquidity constraints faced by some institutions, mitigation of risk due to high real estate exposure, implementing corporate governance practices in business operations, listing of RFCs on the Colombo Stock Exchange and becoming members of the Financial Ombudsman Scheme.

## 26.4 Examination of Financial Institutions

Periodic on-site examinations were carried out to assess the liquidity, asset quality, capital adequacy,

management efficiency, earnings, profitability, systems and controls and the status of corporate governance of financial institutions. A risk based approach was adopted in carrying out these examinations where the focus was on identification of risks, management of risks and assessment of resources to mitigate risks. During 2010, the SNBFI Dept, conducted on-site examinations on 7 RFCs and 5 SLCs. The examination reports highlighting any risks identified and recommendations for corrective actions were provided to the respective Boards of Directors. In addition, 4 RFCs and 4 SLCs were examined on a limited scope basis, selecting critical areas such as liquidity, credit administration, asset portfolio, capital adequacy and systems and controls. The Boards of Directors of respective entities that were identified with significant supervisory concerns were required to submit firm commitments with specific time frames for corrective action. Main supervisory concerns raised inter alia were non-compliance with the direction on corporate governance, improvements needed for better risk management and lack of prudence in dealing with related parties.

## 26.5 Business Revival Plan of Distressed RFCs

During the year, a significant quantum of resources of the SNBFI Dept, was directed towards the business revival of 6 RFCs and one SLC that had confronted severe liquidity constraints. Continuing from last year, the management of these companies were overseen by the Managing Agents appointed by the Monetary Board. The SNBFI Dept, closely monitored the performance of these distressed companies through regular meetings held with Boards of Directors, Senior Management and the Managing Agents and prospective investors. In the light of safeguarding depositors' interests and the stability of the financial system, proposals on business revival were reviewed with professional support of the Expert Panel of four members appointed by the Cabinet of Ministers in 2009. Accordingly, certain companies were allowed to proceed with the proposed plans where appropriate. With respect to certain other distressed companies, the Monetary Board under the powers vested to it under the relevant statutes issued directions on recapitalization strategies. The Business Revival Plans of these entities involved one or more means of recapitalization by way of issue of fresh

equity through a public issue or a private placement, disposal of real estate properties and conversion of part of deposit liability into equity. Accordingly, towards the end of 2010 one of the distressed companies successfully revived its operations and progressed satisfactorily into normal operations. Consequently, the Managing Agent appointed was released by the end of the year. Other companies were nearing the finalization of the plans by the end of 2010.

## 26.6 Other Activities

### (a) Progress of proposed new legislation

In May 2010, the Cabinet of Ministers granted approval to introduce new legislation to regulate finance business by repealing and replacing the FCA 1988. The need to amend the FCA has been felt by the financial sector as well as the regulator in order to update the law to facilitate the prudent business practices, effective combat of deposit-taking businesses without permission and enhancing effective regulation to overcome challenges to the stability of the financial sector. The Cabinet of Ministers on 29th December 2010 granted approval for the draft bill to be submitted to the Parliament. Further, drafting the law to establish a supervisory mechanism to regulate business activities of microfinance institutions (MFIs) was in progress. Under the proposed regulatory mechanism, an independent authority will be established for the purpose. Consequent to a proposal submitted by the Central Bank to the Ministry of Finance and Planning, the Cabinet of Ministers granted approval in July 2010 to draft a Microfinance bill and the Legal Draftsman Department will draft the bill.

### (b) Public Awareness Programmes

The Department continued to educate the public on conduct of finance business without permission. The public awareness programmes included the following:-

- (i) Press notices with explanatory notes providing the definition of deposits, categories of institutions/ organizations authorised to accept deposits under different laws and a list of institutions authorised by the Central Bank to accept deposits.
- (ii) Conduct of eleven awareness programme meetings in various areas to educate the public on the activities of finance companies and the risk of investing in unauthorised finance businesses.
- (iii) Leaflets titled "Mobilisation of Funds from the Public by Unauthorised Persons & Institutions" were distributed among the public through provincial offices of the Central Bank.

### (c) Liquidation Process of Failed Finance Companies

Out of the eleven finance companies that failed in 1990s, the liquidation process of five has been completed while the process of liquidation continues in relation to the other six companies. During the year, the Central Bank collected around Rs. 168 million from these finance companies in respect of refinance loans granted to them.

### (d) Action on conduct of finance business without permission

The SNBFI Dept, commenced investigations on 14 persons/institutions under the Section 11 of the FCA based on the complaints it had received and continued investigations on 45 other institutions. Meanwhile, the Department provided secretarial facilities to the Committee of Chartered Accountants appointed by the Supreme Court to safeguard the interest of the investors/ security-depositors who filed Fundamental Rights Applications against two institutions that collected funds from the public and defaulted repayment. By the end of the year, 8,110 investors/security-depositors of the Golden Key Credit Card Company were paid Rs. 805.5 million under the Phase I of the repayment plan while the cost involved in secretarial services was Rs. 37 million.

**Registered Finance Companies and Registered Finance Leasing Establishments**

<b>Institutions registered with the Central Bank in accordance with the law (As at end 2010)</b>	
<b>Registered Finance Companies</b>	<b>Registered Finance Leasing Establishments</b>
<ol style="list-style-type: none"> <li>1. Abans Financial Services Ltd.</li> <li>2. Alliance Finance Company PLC.</li> <li>3. AMW Capital Leasing Ltd.</li> <li>4. Arpico Finance Company PLC.</li> <li>5. Asia Assets Finance Ltd.</li> <li>6. Asian Finance Ltd.</li> <li>7. Associated Motor Finance Company Ltd.</li> <li>8. Bartleet Finance Ltd.</li> <li>9. Bimpuh Lanka Investments Ltd.</li> <li>10. Central Finance Company PLC.</li> <li>11. Central Investments &amp; Finance Ltd.</li> <li>12. Chilaw Finance Ltd.</li> <li>13. Citizens Development Business Finance PLC</li> <li>14. Commercial Credit Ltd.</li> <li>15. Edirisinghe Trust Investments Ltd.</li> <li>16. Grameen Micro Credit Company Ltd.</li> <li>17. Industrial Finance Ltd.</li> <li>18. Kanrich Finance Ltd. (formerly Nextfinance Ltd.)</li> <li>19. Lanka ORIX Finance Company Ltd.</li> <li>20. LB Finance PLC.</li> <li>21. Mercantile Investments Ltd.</li> <li>22. Merchant Credit of Sri Lanka Ltd.</li> <li>23. Nanda Investments Ltd.</li> <li>24. People's Leasing Finance PLC</li> <li>25. People's Merchant Finance Company Ltd. (formerly Silverreen Finance Co. Ltd)</li> <li>26. Senkadagala Finance Company Ltd.</li> <li>27. Singer Finance (Lanka) Ltd.</li> <li>28. Sinhaputhra Finance PLC.</li> <li>29. Soflogic Finance PLC. (formerly Capital Reach Leasing PLC)</li> <li>30. Swarnamahahal Financial Services Ltd.</li> <li>31. The Finance &amp; Guarantee Company Ltd.</li> <li>32. The Finance Company PLC.</li> <li>33. The Multi Finance Company Ltd.</li> <li>34. The Standard Credit Lanka Ltd. (formerly Ceylinco Investment and Reality Ltd)</li> <li>35. Trade Finance &amp; Investments Ltd.</li> <li>36. Vallibel Finance PLC.</li> <li>37. TKS Finance Ltd.</li> </ol>	<ol style="list-style-type: none"> <li><b>(A) Licensed Commercial Banks</b> <ol style="list-style-type: none"> <li>1. Bank of Ceylon</li> <li>2. Commercial Bank of Ceylon PLC.</li> <li>3. Hatton National Bank PLC.</li> <li>4. MCB Bank Ltd.</li> <li>5. National Development Bank PLC.</li> <li>6. Nations Trust Bank PLC.</li> <li>7. Pan Asia Banking Corporation PLC.</li> <li>8. People's Bank</li> <li>9. Sampath Bank PLC.</li> <li>10. Seylan Bank PLC.</li> <li>11. Union Bank of Colombo Ltd.</li> </ol> </li> <li><b>(B) Licensed Specialised Banks</b> <ol style="list-style-type: none"> <li>1. MBSL Savings Bank Ltd (Formerly Ceylinco Savings Bank Ltd)</li> <li>2. DFCC Bank</li> <li>3. Lankaputhra Development Bank Ltd</li> <li>4. Sanasa Development Bank Ltd</li> </ol> </li> <li><b>(C) All Registered Finance Companies listed above except Bimpuh Lanka Investments Ltd., Grameen Micro Credit Company Ltd. and TKS Finance Ltd.</b></li> <li><b>(D) Specialised Leasing Companies (SLCs)</b> <ol style="list-style-type: none"> <li>1. Asia Commerce Ltd.</li> <li>2. Assetline Leasing Company Ltd.</li> <li>3. Ceylease Financial Services Ltd.</li> <li>4. Ceylinco Leasing Corporation Ltd.</li> <li>5. Commercial Leasing Company Ltd.</li> <li>6. Co-operative Leasing Company Ltd.</li> <li>7. Indra Finance Ltd.</li> <li>8. Isuru Finance Company Ltd.</li> <li>9. Kalutota Investments &amp; Leasing Ltd.</li> <li>10. Koshiha Leasing Company Ltd.</li> <li>11. Lanka ORIX Leasing Company PLC.</li> <li>12. Lisvin Investments Ltd.</li> <li>13. LOLC Micro Credit Ltd.</li> <li>14. Merchant Bank of Sri Lanka PLC.</li> <li>15. Nation Lanka Finance PLC</li> <li>16. Orient Financial Services Corporation Ltd.</li> <li>17. People's Leasing Company Ltd.</li> <li>18. People's Merchant Bank PLC.</li> <li>19. Sampath Leasing &amp; Factoring Ltd.</li> <li>20. SMB Leasing PLC.</li> <li>21. Soflogic Credit Ltd. (Formerly Capital Reach Credit Ltd.)</li> </ol> </li> </ol>

## 27. WELFARE

The Welfare Department (WD) continued to extend welfare facilities to all beneficiaries in an efficient and effective manner during 2010 as well. The benefits were provided to all employees, pensioners, widows, widowers and their registered dependents exceeding nearly 12,000. The facilities provided by the WD included concessionary loans, reimbursements of medical expenditure, in-house health clinic, restaurant services, railway warrants, group insurance policy for employees to cover accidents during off duty hours and awareness programmes on health and other related topics. In addition, the WD played a prominent role in organizing the events relating to the 60th anniversary celebrations of the CBSL.

The WD granted 1179 loans including Provident Fund Loans, Vehicle Loans, Computer Loans and other loans under the Staff Benefit Scheme during 2010 to provide financial assistance for major life cycle events of beneficiaries within five working days after submission of the application with all relevant documents. Furthermore, WD approved 129 new Housing Loans and disbursement of loan installements during this period. The introduction of the loan monitoring system has enabled accurate and speedy disbursement of loans to employees.

The CBSL restaurant continued the self-service system in providing breakfast and lunch to the CBSL staff as well as to the staff of other institutions located in the Bank's premises. The tea service provided by the WD also continued during this period. In addition, the food and beverage services were extended to all departments and senior management based on special requests, to their satisfaction. When compared with the previous year, the daily income from canteen facilities and special requests have increased up to Rs. 14,023,576 and Rs. 1,678,614 respectively. This is an increase of 15.86 per cent and 45.86 per cent respectively from the previous year.

The WD continued reimbursement of medical expenditure for all registered beneficiaries. Medical centre facilities were available for the bank employees during working hours. Quality of medical services were improved by outsourcing the service from a reputed hospital. Medicine and limited laboratory services were provided at a reasonable price at the medical centre. The computerisation of records of the medical centre was completed during the year and the new system will be operational commencing January 2011. With this, all medical records of employees will be maintained electronically. The WD continued to conduct health camps and several awareness programmes for the benefit of the staff.