



Annual Financial Statements

For the year ended 31 December 2008



**FINANCE DEPARTMENT
CENTRAL BANK OF SRI LANKA**

Annual Financial Statements

For the year ended 31 December 2008



Central Bank of Sri Lanka

CENTRAL BANK OF SRI LANKA

THE MONETARY BOARD

(As at 31 December 2008)

AJITH NIVARD CABRAAL

Governor

S. ABEYSINGHE

Secretary to the Ministry of Finance and Planning

TILAK DE ZOYSA

Appointed Member

NIMAL WELGAMA

Appointed Member

Mrs. M. RAMANATHAN

Appointed Member

PRINCIPAL OFFICERS

(As at 31 December 2008)

Deputy Governors

W. A. WIJEWARDENA

Mrs. R. JAYAMAHA

Assistant Governors

Appointed on 17.07.2001

Mrs. M. A. R. C. COORAY

(Secretary to the Monetary Board)

Appointed on 01.06.2004

K. G. D. D. DHEERASINGHE (on release)

P. D. J. FERNANDO

Appointed on 11.10.2006

P. W. R. B. A. U. HERAT

H. N. THENUWARA

D. S. WIJESINGHE

Appointed on 03.12.2007

S. H. A. M. ABEYRATNE

Mrs. C. PREMARATNE

P. SAMARASIRI

DEPARTMENTAL HEADS

Bank Supervision Department

B. D. W. A. SILVA	–	<i>Director</i>
Mrs. T. M. J. Y. P. FERNANDO	–	<i>Additional Director</i>
A. A. M. THASSIM	–	<i>Additional Director</i>

The Centre for Banking Studies

U. P. ALAWATTAGE	–	<i>Director</i>
K. P. N. S. KARUNAGODA	–	<i>Additional Director</i>

Communications Department

S. J. A. HANDAGAMA	–	<i>Director</i>
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Currency Department

C. P. A. KARUNATILAKE	–	<i>Superintendent</i>
G. D. GUNARATHNA	–	<i>Additional Superintendent</i>

Domestic Operations Department

A. KAMALASIRI	–	<i>Director</i>
D. A. G. K. WIJETUNGA	–	<i>Additional Director</i>

Economic Research Department

P. N. WEERASINGHE	–	<i>Director</i>
K. D. RANASINGHE	–	<i>Additional Director</i>
Mrs. S. GUNARATNE	–	<i>Additional Director</i>

Employees' Provident Fund Department

D. WASANTHA	–	<i>Superintendent</i>
Mrs. K. GUNATILAKE	–	<i>Additional Superintendent</i>
U. H. E. SILVA	–	<i>Additional Superintendent</i>

Exchange Control Department

E. A. HETTIARACHCHI	–	<i>Controller</i>
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Financial Intelligence Unit

H. A. KARUNARATNE	–	<i>Director</i>
D. M. RUPASINGHE	–	<i>Additional Director</i>

Finance Department

Mrs. K. M. A. N. DAULAGALA	–	<i>Chief Accountant</i>
P. V. L. NANDASIRI	–	<i>Additional Chief Accountant</i>

Financial System Stability Department

Ms. K. SARAVANAMUTTU	–	<i>Director</i>
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Human Resources Department

S. LANKATHILAKE	–	<i>Director</i>
A. R. K. WIJESEKERA	–	<i>Additional Director</i>

Information Technology Department

Mrs. R. A. S. M. DAYARATHNA	–	<i>Director</i>
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International Operations Department

Mrs. P. LIYANAGE	–	<i>Director</i>
R. A. A. JAYALATH	–	<i>Additional Director</i>

Management Audit Department

M. I. SUFIYAN	–	<i>Director</i>
F. C. S. MENDIS	–	<i>Additional Director</i>

Payments and Settlements Department

Mrs. J. P. MAMPITIYA	–	<i>Director</i>
K. B. DISSAKARUNA	–	<i>Additional Director</i>

Policy Review and Monitoring Department

W. M. HEMACHANDRA	–	<i>Director</i>
P. W. D. N. R. RODIRIGO	–	<i>Additional Director</i>

Premises Department

Y. A. DE SILVA	–	<i>Director</i>
R. J. PERERA	–	<i>Additional Director</i>

Public Debt Department

C. J. P. SIRIWARDENA	–	<i>Superintendent and Registrar</i>
C. N. WIJAYASEKERA	–	<i>Additional Superintendent</i>

Regional Development Department

W. M. KARUNARATNE	–	<i>Director</i>
P. G. JAYASOORIYA	–	<i>Additional Director</i>

Secretariat Department

Mrs. C. K. NANAYAKKARA	–	<i>Secretary</i>
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Security Services Department

S. WANIGASEKARA	–	<i>Director</i>
H. M. EKANAYAKE	–	<i>Additional Director</i>

Statistics Department

S. SOMAPALA	–	<i>Director</i>
M. J. S. ABEYSINGHE	–	<i>Additional Director</i>

Supervision of Non-Bank Financial Institutions Department

S. S. RATNAYAKE – *Director*
P. H. O. CHANDRAWANSA – *Additional Director*
J. P. R. KARUNARATNE – *Additional Director*

Welfare Department

Mrs. S. N. PERERA – *Director*

CONSULTANTS

Legal Department

P. M. M. PIERIS – *Consultant*
(up to 18 December 2008)

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Governor's Statement

The financial year 2008 has been a challenging year for the Central Bank amidst the global economic meltdown which has affected developing nations such as Sri Lanka too. However, the Central Bank has been able to implement successfully the strategies stipulated in its Strategic Plan of 2008-2012, with emphasis on its two core objectives of economic and price stability and financial system stability.

Review of Operations

The Sri Lankan economy grew by 6 per cent in 2008, the fourth successive year to record a growth of 6 per cent or more, demonstrating the strength and resilience of the economy. In 2008, this growth was achieved in the midst of unparalleled adverse developments in the global economy, as well as certain disturbances in the domestic front. During the first half of the year, the surge in food and energy prices in the global market threatened macroeconomic stability with sharply widening trade and current account deficits and rising inflation. On the domestic front, increased expenditure on re-settlement, rehabilitation and reconstruction in the Eastern Province and on defence related expenditures, as well as deceleration of revenue collection arising from duty waivers granted to minimise the impact of high food and energy prices and slowing economic activities exerted pressure on the fiscal accounts.

In 2008, all key sectors of the economy contributed positively to the growth. The growth performance was impressive in the first nine months of the year with a growth rate of 6.5 per cent. However, with the adverse external sector developments impacting on the economy towards the latter part of 2008, the growth decelerated to 4.3 per cent in the last quarter of 2008, resulting in an annual growth rate of 6 per cent. The industry and services sectors decelerated to 5.9 per cent and 5.6 per cent, respectively, due to the lower external demand and slowing domestic economic activity. However, the Agriculture sector grew at an impressive rate of 7.5 per cent benefiting from conducive weather conditions and attractive prices. The continuation of major infrastructure development projects also contributed significantly to maintain the growth momentum in 2008. With these developments, the per capita income increased to US dollars 2,014, while the unemployment rate declined to the lowest ever recorded level of 5.2 per cent, in 2008.

With the deepening of the global financial crisis and reversal of global capital flows towards the latter part of the year, Sri Lanka also had to cope with the sudden withdrawal of foreign investment which resulted in the decline of almost 50 per cent of its external official reserves, which had been prudently accumulated to the highest ever level of US dollars 3.6 billion by end July 2008. Consequently, the balance of payments surplus of US dollars 500 million recorded by end July 2008 turned into a deficit of US dollars 1.2 billion by end 2008.

In this background, the Central Bank took several measures to increase foreign inflows in 2008. It undertook negotiations for several bilateral currency SWAP arrangements. Under one such arrangement, the Central Bank received US dollars 200 million in February 2009. In addition, actions were initiated to promote investments in Treasury bills and bonds among the Sri Lankan diaspora and a 20 per cent bonus interest was granted on NRFC and RFC accounts to encourage a higher level of inflows. Further, the government has sought a Stand-by Arrangement from the International Monetary Fund (IMF).

In the midst of above challenges, the Central Bank continued its focus on achieving its two key objectives, namely economic and price stability and financial system stability. The Bank's monetary policy strategy, which relied mainly on restricting monetary expansion through quantitative targeting, proved to be effective with year-on-year inflation decelerating from 28.2 per cent in June 2008 to 7.6 per cent by end February 2009. Falling global food and energy prices, as well as favourable domestic agriculture production, reinforced monetary policy efforts to achieve price stability.

With the continued tight monetary policy, the annual average reserve money growth moderated to around 8.5 per cent, as compared to the annual target of 9.7 per cent. In tandem with the trend in reserve money and resultant high interest rates, the expansion in broad money also decelerated significantly to 8.5 per cent by end 2008, as compared to an expected growth of 11 per cent. However, in view of the implications of the global financial crisis and economic slowdown, the Central Bank has relaxed monetary policy to some extent, starting from the last quarter of 2008. Accordingly, the Central Bank reduced the Statutory Reserve Requirement (SRR) on all rupee deposit liabilities of commercial banks on three occasions by a total of 300 basis points, to 7.0 per cent, while policy interest rates were reduced by 25 basis points. The penal interest rate applicable on reverse repurchases from the Central Bank was also reduced by 425 basis points, to 14.75 per cent.

The financial system continued to be resilient in the challenging environment of the global financial crisis and emerging world economic downturn and the higher domestic interest environment. The financial services industry grew at a more moderate pace during the year, in response to the tighter monetary policy stance adopted to reduce inflationary pressures and slower economic growth resulting from the global financial and economic crisis. Overall, the key financial institutions maintained their soundness with sustained profitability, increased capitalisation and improvements in risk management, supported by enhanced regulation and supervision. The stronger financial positions built-up by these institutions in recent years has enabled them to cope with the elevated level of risks encountered during the year. The systematically important payment and settlement system – LankaSettle, operated with a high degree of safety and system availability of 99.65% during the year.

The Central Bank introduced several directions during the year to strengthen the prudential regulation and supervision of licensed banks. The Direction on Basle II Capital Adequacy Framework dealt with the implementation of Pillar I under the standardised approach credit risk, standard measurement approach for market risk and basic indicator approach for operational risk, with effect from January 2008. A revised Direction on Classification of Loans and Advances, Income Recognition and Provisioning was aimed at improving credit risk management in banks. Further Directions on Corporate Governance which also came into effect in 2008, related to amendments to certain transitional provisions with respect to the age limit, length of service and the number of directorships that could be held by directors of licensed banks, were also issued. Other directions issued during the year related to outsourcing activities, and margin requirements on letters of credit and forward sales transactions. The Central Bank also issued guidelines to banks on Integrated Risk Management Systems and a road-map for the adoption of Sri Lanka Accounting Standards 44 and 45.

Directions were also issued to Registered Finance Companies specifying limits on the maximum interest rate on deposits, bonds and other instruments, with the objective of lowering the cost of funds and reducing lending rates, which became applicable in April and on Corporate Governance which came into effect from 2009. The anti-money laundering framework was also widened and strengthened. The Financial Intelligence Unit issued directives to insurance companies on "Know Your Customer and Customer Due Diligence" (KYC & CDD) procedures. In addition, further directives were issued to banks, financial companies and stock-broker companies to enforce strict compliance with KYC and CDD reporting requirements while raising the threshold for reporting all cash transactions and electronic fund transfers to Rs.1 million.

The Central Bank also conducted a more intensive public awareness programme to caution the public against the danger of depositing funds and investing funds unauthorised finance businesses, many of which are scams. Investigations were carried out and legal action has been initiated against some of these entities.

Towards the end of the year, the Central Bank intervened to avoid and potential danger to the stability of financial system by taking decisive action to stabilize Seylan Bank PLC, a systematically important bank that was experiencing a loss of market confidence and liquidity problems due to the failure of a related unregulated company, by changing the board of directors of the bank and by appointing the state owned Bank of Ceylon to carry on the business of Seylan Bank. The intervention quickly restored the stability of the Bank.

The 2008 Annual Report of the Bank, which is published separately, carries the financial statements of the Bank prepared in accordance with the Monetary Law Act (MLA) and audited by the Auditor General. The financial statements presented as part of this publication have been prepared in accordance with the International Financial Report Standards (IFRS).

Acknowledgements

During the year the Bank interacted closely with the President and Minister of Finance, His Excellency Mahinda Rajapaksa and we greatly value His Excellency's guidance, commitment and co-operation towards the achievement of the Central Bank's goals. The cooperation extended by the Deputy Ministers of Finance, Honourable Dr. Sarath Amunugama and Honourable Ranjith Siyambalapatiya, the Secretary to the Treasury, Mr. S. Abeysinghe and the Government of Sri Lanka, towards the Bank's achievements is greatly appreciated. We also wish to thank the Auditor General, Mr. S. Swarnajothi and M/s. Ernst & Young for their ready cooperation in auditing the Bank's financial statements.

We also wish to express our gratitude to the Members of the Monetary Board, Mr. S. Abeysinghe, Mr. Thilak de Zoysa, Mrs. Manohari Ramanathan, Mr. Nimal Welgama and the Secretary, Mrs. Rose Cooray, for their valuable contributions and commitment towards the Bank's progress. I also wish to record my appreciation of the services rendered by members of the Monetary Board Advisory Audit committee, Mr. Nimal Welgama (former Chairman), Mr. Reyaz Mihular (member) and Mrs. Jacintha Patrick (member) in 2008, and welcome Mrs. Manohari Ramanathan who is the Chairperson for the year 2009. I am certain that their guidance would be of immense value in steering the Central Bank towards high standards of corporate governance and audit practices.

Finally, on behalf of the Monetary Board, I wish to thank the Deputy Governors, Mr. W.A. Wijewardena and Dr. Raneey Jayamaha, for their unstinted co-operation, the Corporate Management Committee, the Departmental Heads and the entire staff for their commitment towards achieving the Bank's mission; the Trade Unions for their co-operation towards the progress of the Bank; and all others who made the achievements of the year 2008 possible.



Ajith Nivard Cabraal

Governor

Colombo, 31 March 2009

Monetary Board Advisory Audit Committee Report

A new Board Advisory Audit Committee (AC) was appointed and functioned during the year 2008.

The AC consisted of three Members, Mr. N Welgama Appointed Member of the Monetary Board (Chairman), Mr. M R Mihular (Partner - KPMG Ford, Rhodes, Thornton & Co.) and Mrs. A M J Patrick (Partner – SJMS Associates). Dr. P.W.R.B.A.U. Herat, Assistant Governor, functioned as the Secretary to the Committee.

During the financial year 2008 the AC met on 3 occasions and carried out the following tasks:

- Re-examined and confirmed its Terms of Reference;
- Reviewed the draft final accounts of CBSL for 2007 prior to the signing off by auditors;
- Followed up the issues highlighted by the External Auditors in their Management Letter on the 2007 accounts of the Central Bank. The following main recommendations were made by the AC in relation to issues raised:
 - a. A check list of specific areas that need special attention to be submitted by the external auditors;
 - b. Staff loans granted at concessionary rates to be fair valued as per IFRS;
 - c. Fixed Assets to be depreciated from the date the asset is available for use, irrespective of whether the asset is in use or not.
- Approved the Internal Audit Plan for 2008 of the Management Audit Department and emphasised the need for a more risk based approach.
- Discussed and agreed that in the case of CBSL, its holdings of gold may be considered as an investment and not a commodity and hence the gold held with the CBSL should be fair valued and the gain or loss be transferred to profit and loss.
- Conducted in depth discussions with the Economic Research Department to examine the basis for determining the discount rate used for estimating the liabilities of the post employment benefit schemes.
- Reviewed the assumptions and policies which form part of the financial statements of 2008.

Auditor's Report



ERNST & YOUNG

Chartered Accountants

201 De Saram Place
P.O. Box 101
Colombo 10
Sri Lanka

Tel : (0) 11 2463500
Fax Gen : (0) 11 2697369
Tax : (0) 11 5578180
eysl@lk.ey.com

HMAJ/SPF/HLF/PATR

Independent Auditor's Report to the Members of the Monetary Board of the Central Bank of Sri Lanka

We have audited the accompanying Balance Sheet of the Central Bank of Sri Lanka ("Bank") as at 31 December 2008, and the related Income Statement, Cash Flows Statement, Statement of Movements in Equity, Summary of Significant Accounting Policies and other explanatory notes set out on pages 11 to 56 for the year then ended. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statements presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements present fairly, in all material respects the financial position of the Bank as of 31 December 2008 and of the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

6th March 2009
Colombo.

Partners: A D B Talwatte FCA FCMA T K Bandaranayake FCA M P D Cooray FCA FCMA Ms. Y A De Silva ACA W R H Fernando FCA FCMA
W K B S P Fernando FCA ACMA A P A Gunasekera FCA FCMA A Herath FCA D K Hulangamuwa FCA FCMA LLB (Lond)
A S M Ismail FCA FCMA H M A Jayasinghe FCA FCMA Ms. G G S Manatunga ACA Ms. L C G Nanayakkara FCA FCMA B E Wijesuriya ACA ACMA

Balance Sheet

As at 31 December 2008

	Note	2008 Rs. '000	2007 Rs. '000
ASSETS			
Foreign Currency Financial Assets			
Cash & Cash Equivalents		167,338,807	160,051,979
Financial Assets:			
– Securities at Fair Value through Profit and Loss	5	50,381,845	113,583,131
– Available for Sale Investments	5	41,733,314	79,541,928
Other Foreign Receivables		1,427,899	767,873
IMF Related Assets	6	72,399,875	71,899,462
Total Foreign Currency Financial Assets		333,281,740	425,844,373
Local Currency Financial Assets			
Investment Portfolio - Sri Lanka Government Securities		159,771,674	43,612,184
Advances to Government	7	76,307,700	60,679,200
Loans to Other Institutions	8	1,577,301	2,093,651
Other Local Receivables		659,770	706,767
Investments in Financial and Other Institutions	9	50,729	50,135
Other Assets		1,364,690	1,230,687
Total Local Currency Financial Assets		239,731,864	108,372,624
Total Financial Assets		573,013,604	534,216,997
Foreign Currency Non-Financial Assets			
Securities Denominated in Gold		10,427,432	13,991,886
Local Currency Non-Financial Assets			
Inventories	10	1,961,687	1,665,348
Gold Inventory being Refined		–	59,766
Sundry Assets		2,405,922	2,155,045
Property, Plant and Equipment	11	9,242,988	9,354,648
Intangible Assets	12	15,717	953
Total Non-Financial Assets		24,053,746	27,227,646
Total Assets		597,067,350	561,444,643

Balance Sheet (continued)

As at 31 December 2008

	Note	2008 Rs. '000	2007 Rs. '000
LIABILITIES AND EQUITY			
Foreign Currency Financial Liabilities			
Amounts Payable to Banks and Financial Institutions	13	336,091	6,730,522
Amounts Payable to Asian Clearing Union	14	91,354,909	48,454,327
IMF Related Liabilities	15	95,133,658	102,291,389
Other Foreign Payables		1,517,077	1,615,652
Total Foreign Currency Financial Liabilities		188,341,735	159,091,890
Local Currency Financial Liabilities			
Deposits by Banks and Financial Institutions	16	82,311,214	91,053,024
Balances with Government and Governmental Entities	17	1,245,624	1,416,075
Securities Sold under Agreement to Repurchase		13,743,000	18,000
Balances with Employee Benefit Plans	18	1,155,061	2,250,167
Other Payables		1,664,352	1,923,545
Total Local Currency Financial Liabilities		100,119,251	96,660,811
Total Financial Liabilities		288,460,986	255,752,701
Other Liabilities			
Currency in Circulation	19	186,098,914	173,363,722
Deferred Grants	20	–	68
Pension and Other Post Employment Benefit Plans	35	1,026,698	324,182
Miscellaneous Liabilities and Accruals		531,960	614,603
Total Other Liabilities		187,657,572	174,302,575
Total Liabilities		476,118,558	430,055,276
Equity			
Capital Funds	21	25,000,000	15,000
Reserves		95,948,792	131,374,367
Total Equity		120,948,792	131,389,367
Total Liabilities and Equity		597,067,350	561,444,643

The Governor and the Chief Accountant of the Central Bank of Sri Lanka authorised these financial statements for issue on 6th March 2009, for and on behalf of the Bank :



Ajith Nivard Cabraal – Governor



K. M. A. N. Daulagala – Chief Accountant

The Accounting Policies and Notes on pages 11 through 56 form and integral part of the Financial Statement.

Statement of Movements in Equity

Year ended 31 December 2008

	Contributed Capital Rs. '000	Reserves Appropriated as Capital Rs. '000	Revaluation Reserve Rs. '000	Other Reserves (Note 21) Rs. '000	Accumulated Profits Rs. '000	Total Rs. '000
As at 01 January 2007	15,000	-	473,057	90,712,965	12,148,493	103,349,515
Net Profit	-	-	-	-	28,825,385	28,825,385
Transfer to RTGS Sinking Fund	-	-	-	46,341	(46,341)	-
Transfer to General Reserve	-	-	-	1,478,488	(1,478,488)	-
Transfer of Net Foreign Exchange Revaluation Gain						
Revaluation Gain	-	-	-	8,812,401	(8,812,401)	-
Transfer to CBSL Specific Reserve	-	-	-	100,914	(100,664)	250
Net Fair Value / (Loss) on Available for Sale Securities	-	-	-	996,817	-	996,817
Gain / (Loss) on Revaluation	-	-	2,233,010	-	-	2,233,010
Transfer of Profit to Government	-	-	-	-	(4,000,000)	(4,000,000)
Spot Position Effect	-	-	-	-	(520)	(520)
Transfer of Sales Proceeds of Kandy Property	-	-	-	-	(15,090)	(15,090)
As at 31 December 2007	15,000	-	2,706,067	102,147,926	26,520,374	131,389,367
Net Loss	-	-	-	-	(5,044,424)	(5,044,424)
Transfer to RTGS Sinking Fund	-	-	-	63,294	(63,294)	-
Transfer to General Reserve	-	-	-	11,722,139	(11,722,139)	-
Transfer of Net Foreign Exchange Revaluation Gain	-	-	-	(22,810,925)	22,810,925	-
Transfer to CBSL Specific Reserve	-	-	-	150,377	(150,377)	-
Net Fair Value / (Loss) on Available for Sale Securities and Allocated Gold accounts	-	-	-	2,603,850	-	2,603,850
Transfer of funds from General Reserve to Reserve Appropriated as Capital	-	24,985,000	-	(24,985,000)	-	-
Transfer of Profit to Government	-	-	-	-	(8,000,000)	(8,000,000)
As at 31 December 2008	15,000	24,985,000	2,706,067	68,891,661	24,351,065	120,948,793

Income Statement

Year ended 31 December 2008

	Note	2008 Rs. '000	2007 Rs. '000
Operating Income:			
Income from Foreign Currency Financial Assets			
Interest Income	23	11,129,190	13,240,762
Gain / (Loss) from Unrealised Price Revaluations		2,211,883	4,413,887
Gain / (Loss) Realised from Price Changes		6,648,280	2,189,134
Total Income from Foreign Currency Financial Assets		19,989,353	19,843,783
Expenses on Foreign Currency Financial Liabilities			
Interest Expense	24	(1,301,552)	(2,226,270)
Total Expenses on Foreign Currency Financial Liabilities		(1,301,552)	(2,226,270)
Net Foreign Exchange Revaluation Gain /(Loss)		(22,810,925)	8,812,401
Foreign Currency Investment Income /(Loss)		(4,123,124)	26,429,914
Income from Local Currency Financial Assets			
Interest Income	23	7,043,031	9,516,837
Interest Expense	24	(511,709)	(551,596)
Total Income from Local Currency Financial Assets		6,531,322	8,965,241
Other Income	25	454,250	421,396
Total Net Operating Income / (Loss)		2,862,448	35,816,551
Operating Expenses:			
Personnel Expenses:			
	26		
– Salaries and Wages		(1,718,302)	(1,591,667)
– Defined Contribution Plan Costs		(215,066)	(187,834)
– Additional Contribution to Post Employment Benefit Plan Costs		(1,333,944)	(1,671,606)
		(3,267,312)	(3,451,107)
Depreciation & Amortisation		(302,977)	(270,040)
Cost of Inventory		(926,586)	(1,052,160)
Administration Expenses	27	(1,472,257)	(1,172,965)
Bad & Doubtful Debts and Net Sundry Write Offs		–	(52)
Total Operating Expenses		(5,969,132)	(5,946,324)
Profit / (Loss) Before Income Tax		(3,106,684)	29,870,227
Income Tax	28	(1,937,740)	(1,044,842)
Net Profit / (Loss) for the Year		(5,044,424)	28,825,385

Cash Flow Statement

Year ended 31 December 2008

	Note	2008 Rs. '000	2007 Rs. '000
Cash Flow from Operating Activities:			
Source:			
Interest Received – Foreign Currency		11,970,696	13,091,488
Interest Received – Local Currency - Others		688,187	380,567
Liquidity Management and Trading Income		6,648,280	2,189,134
Realised Exchange Gain / (Loss)		(269,850)	89,345
Other Income Received		454,182	348,438
		19,491,495	16,098,972
Disbursements:			
Interest Paid – Foreign Currency		1,447,241	2,234,299
Interest Paid – Local Currency		507,687	552,055
Payments to Employees		3,608,251	1,782,510
Payments to Suppliers		(23,623,338)	3,583,244
Income Tax Paid		28,611,636	663,653
		10,551,477	8,815,761
Net Cash Flow from Operating Activities	29	8,940,018	7,283,211
Cash Flows from Investing Activities:			
Source:			
Net (Increase) / Decrease in Other Local Currency Financial Assets		(304,851)	(822,394)
Principal recoveries from the Loans and Advances to Other Institutions		252,307	393,795
Disposal / Redemption of Investments in Financial and Other Institutions		(594)	(4,950)
Sale of Property, Plant and Equipment		–	–
Income on Investments in Financial and Other Institutions		–	28,591
Net Increase / (Decrease) in Securities Purchased under Agreement to Re-sell		13,725,000	(544,000)
		13,671,863	(948,958)
Disbursements:			
Net Increase / (Decrease) in Foreign Currency Securities		(86,444,960)	6,186,179
Net Increase / (Decrease) in Other Foreign Currency Financial Assets		(541,626)	587,990
Net Increase / (Decrease) in Other Foreign Currency Financial Liabilities		(33,914,788)	(12,345,621)
Net Increase / (Decrease) in Other Local Deposits and Payables		(4,861)	4,409
Purchase of Property, Plant and Equipment net of Grants		(2,269,492)	221,447
Net Increase / (Decrease) in Gold Inventory		206,080	(181,599)
		(122,969,647)	(5,527,195)
Net Cash Flow from Investing Activities		136,641,510	4,578,237

Cash Flow Statement (continued)

Year ended 31 December 2008

	Note	2008 Rs. '000	2007 Rs. '000
Cash Flows from Financing Activities:			
Source:			
Issue of Circulating Currency		219,507,915	209,034,025
Withdrawal of Circulating Currency		(206,772,722)	(192,909,909)
Net Issue of Circulating Currency		12,735,193	16,124,116
Less:			
Net Issue / (Withdrawals) of Circulation Currency on Government Transactions	30	125,419,584	(21,422,909)
Net Issue / (Withdrawals) of Circulation Currency on Banks and Financial Institutions Transactions	31	8,741,810	(8,564,417)
Net Issue / (Withdrawals) of Circulating Currency		134,161,394	(29,987,326)
		(121,426,201)	46,111,442
Disbursements:			
Repayment of Foreign Currency Term Liabilities		8,313,981	605,092
Payments to Other Funds		-	15,090
Payments of Surplus to Government		8,000,000	4,000,000
		16,313,981	4,620,182
Net Cash Flow from Financing Activities		(137,740,182)	41,491,260
Net Increase in Cash and Cash Equivalents		7,841,345	53,352,706
Exchange Rate Effect on Cash and Cash Equivalents		(554,517)	1,097,587
Cash and Cash Equivalent at the Beginning of the Year		160,051,979	105,601,686
Cash and Cash Equivalent at 31 December	32	167,338,807	160,051,979

Notes to be read as Part of the Financial Statements

For the year ended 31 December 2008

1. Reporting Entity and Statutory Base

These are the special purpose IFRS financial statements (financial statements) of the Central Bank of Sri Lanka ("Bank" or "CBSL"), the 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 on 6th of March 2009.

2. Accounting Policies

2.1. Basis of preparation

The financial Statements are prepared on the historical cost basis, except for land & building 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 balance sheet 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 Central Bank of Sri Lanka for the year ended 31 December 2008 have been prepared in accordance with International Financial Reporting Standard (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

All amounts in Sri Lanka Rupees are expressed in thousands, unless otherwise stated.

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 35.

Notes to be read as Part of the Financial Statements

For the year ended 31 December 2008

2.3. Adoption of Amended IFRS during the year

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

2.3.1. Standards, interpretations and amendments to published standards that are not yet effective

Certain new standards, amendments and interpretations to existing standards have been published that are applicable for the Bank's accounting periods beginning on or after 1 January 2009 but which the Bank has not early adopted, as follows:

IFRS 8, Operating Segments (effective from 1 January 2009) – IFRS 8 specifies how an entity should report information about its operating segments in annual financial statements. The Bank is in the process of assessing the impact of IFRS 8 and its voluntary application.

3. Summary of Significant Accounting Policies

3.1 Foreign Currency Conversions

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 balance sheet 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:

	2008 December Rs.	2007 December Rs.
1 Australian Dollar	78.0495	95.5807
1 Canadian Dollar	92.7604	111.0061
1 Euro	159.4536	160.2741
1 Japanese Yen	1.2524	0.9713
1 Special Drawing Rights (SDR)	174.2660	171.8040
1 Sterling Pound	163.2777	217.1507
1 United States Dollar	113.1398	108.7194

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.

Notes to be read as Part of the Financial Statements

For the year ended 31 December 2008

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 Balance Sheet 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 Balance Sheet under reserves.

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 Balance Sheet) 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.

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 Bank as part of this Reserve. Hence, Bank holds Rs. 10,427,431 in gold as part of its International Reserves as at 31 December 2008. As this gold is part of the International Reserve and not used as a commodity which is traded during the normal course of business, (hence, not a financial instrument as per the definition in IAS) gold is fair valued and the gains or losses are transferred to the income statement. Prior to appropriation of profits, the unrealized gains or losses from gold are transferred to the relevant reserve account

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 Balance Sheet.

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 as an asset records quota with the IMF 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 balance sheet 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.

Notes to be read as Part of the Financial Statements

For the year ended 31 December 2008

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 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 29 and Note 30 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 Cash Flow Statement, 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 Balance Sheet. 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 Balance Sheet (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 Government of Sri Lanka. The portfolio is recorded in the Balance Sheet at amortised cost since they represent loans provided to the GOSL.

Advances to Government

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

Notes to be read as Part of the Financial Statements

For the year ended 31 December 2008

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 Lending

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

Impairment of Financial Assets

The Bank assesses at each balance sheet 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 amortised 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 recognised 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 recognised 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 recognised, the previously recognised impairment loss is reversed. Any subsequent reversal of an impairment loss is recognised in the income statement, to the extent that the carrying value of the asset does not exceed its amortised 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 amortisation) and its current fair value, less any impairment loss previously recognized in profit and loss, is transferred from equity to the income statement. Reversals in respect of equity instruments classified as available-for-sale are not recognised in profit. Reversals of impairment losses on debt instruments are reversed through profit and loss, if the increase in fair value of the instrument can be objectively related to an event occurring after the impairment loss was recognised in profit and 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 Balance Sheet. 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.

Notes to be read as Part of the Financial Statements

For the year ended 31 December 2008

Financial Guarantees

Financial Guarantees are initially recognised in the financial statements at fair value, in Other Payables, 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

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 Balance Sheet, except to the extent that it reverses a revaluation decrease of the same asset previously recognised in Income Statement, in which case the increase is recognised in Income Statement. A revaluation deficit is recognised in Income Statement, except that a deficit directly offsetting a

Notes to be read as Part of the Financial Statements

For the year ended 31 December 2008

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-recognised 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-recognised. The asset's residual values, useful life 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 life of 4 years.

Receivables

Receivables are carried at expected realisable 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 10.93% and 15 to 30 years 9.78%) .

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 during the year 2008 is considered.
- The date of staff loan granted is considered as 1st January 2008.
- 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 reporting date 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, 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

Notes to be read as Part of the Financial Statements

For the year ended 31 December 2008

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 Central Bank of Sri Lanka represents a claim on the Bank in favour of the holder. The liability for Currency in Circulation is recorded at face value in the Balance Sheet.

Pension and Other Post Employee Benefit Plans

Pension and other Post Employment Benefit Plans operated by the Bank are disclosed in Note 35.

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.

Notes to be read as Part of the Financial Statements

For the year ended 31 December 2008

Income Tax

The income of the Bank is exempt from tax under section 118 of the Monetary Law Act, No. 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-Balance Sheet Items

All guarantees of indebtedness, forward foreign exchange transactions and other commitments, which represents off balance sheet items are shown under respective headings recognised as off balance sheet items. Where applicable, such amounts are measured at best estimates.

4. Nature and Extent of Activities

The Monetary Board of the Central Bank of Sri Lanka 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 Central Bank 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:

Notes to be read as Part of the Financial Statements

For the year ended 31 December 2008

- 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.
- Organisation 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, banks 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 Central Bank of Sri Lanka'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, Euros, Sterling Pounds and Japanese Yen. 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 Central Bank of Sri Lanka 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 Central Bank of Sri Lanka 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 Central Bank of Sri Lanka 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.

Notes to be read as Part of the Financial Statements

For the year ended 31 December 2008

5. Financial Assets

	2008 Rs. '000	2007 Rs. '000
Securities at Fair Value through Profit or Loss Available for Sale Investments	50,381,845	113,583,131
	41,733,314	79,541,928
Total Financial Assets	92,115,159	193,125,059

6. IMF Related Assets

	2008 Rs. '000	2007 Rs. '000
Holding in Special Drawing Rights	220,853	740,172
IMF Quota	72,041,564	71,023,774
Deposits with IMF	137,458	135,516
Total IMF Related Assets	72,399,875	71,899,462

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 balance sheet dates.

IMF Quota

The International Monetary Fund (IMF) is an international organization of 185 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 per cent in its own currency.

A member's quota delineates basic aspects of its financial and organizational relationship with the IMF, including:

- *Subscriptions.* A member's subscription to IMF resources is equal to its quota and determines the maximum amount of financial resources the member is obliged to provide to the IMF. A member must pay its subscription in full: up to 25 per cent must be paid in reserve assets specified by the IMF (SDRs or usable currencies), and the rest in the member's own currency.
- *Voting power.* The quota defines a member's voting power in IMF decisions. Each IMF member has 250 basic votes plus one additional vote for each SDR 100,000 of quota.
- *Access to financing.* The amount of financing a member can obtain from the IMF (access limits) is based on its quota. Under Stand-By and Extended Arrangements, for instance, a member can currently borrow up to 100 per cent of its quota annually and 300 per cent 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 Government of Sri Lanka, 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.

Notes to be read as Part of the Financial Statements

For the year ended 31 December 2008

6. IMF Related Assets (Continued)

PRGF-HIPC Trust Deposit

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

7. Advances to Government

	2008 Rs. '000	2007 Rs. '000
Revolving Credit	76,307,700	60,679,200
Total Advances to Government	76,307,700	60,679,200

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 10 per cent 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. Loans to Other Institutions

	2008 Rs. '000	2007 Rs. '000
Capital Outstanding:		
– Related Parties	48,058	50,670
– Others	2,148,718	2,152,116
	2,196,776	2,202,786
Receivable under Susahana Tsunami Loan Scheme Phase I & II:		
– Related Parties	821,613	1,046,496
– Others	737,404	1,022,861
Interest Receivable	4,220,236	4,218,135
Less:		
Suspended Interest	(4,220,236)	(4,218,135)
Allowance for Doubtful Receivables	(2,178,492)	(2,178,492)
Net Receivable	1,577,301	2,093,651

Notes to be read as Part of the Financial Statements

For the year ended 31 December 2008

8. Loans to Other Institutions (Continued)

Movement in Allowance for Doubtful Receivables is as follows:

	2008 Rs. '000	2007 Rs. '000
At the beginning of the year	2,178,492	2,178,492
At the end of the year	2,178,492	2,178,492

The aggregate amount of non-performing loans on which interest was not recognised amounted to Rs.2,196,776as at 31 December 2008 (2007 Rs. 2,202,786). Unrecognised interest related to such loans amounted to Rs.4,220,236 as at 31 December 2008 (2007 Rs. 4,218,135).

9. Investments in Financial and Other Institutions

- (a) 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.
- (b) Based on the above requirements, the Bank holds the following investments as at the balance sheet date:

Investee	Business	% Holding		Year End
		2008	2007	
Lanka Clear (Pvt) Ltd.	Automated Clearing	19.66	19.66	31 March
Fitch Ratings Lanka Ltd.	Credit Rating	10	10	31 December
Lanka Financial Services Bureau Ltd.	Automated Fund Transfers	7.5	3	31 December
Credit Information Bureau of Sri Lanka Ltd.	Provision of Credit Information	19.9	49	31 December
Held for Sale				
Credit Information Bureau of Sri Lanka Ltd.	Provision of Credit Information	31.04	–	31 December

As per the section 8(5)(a) of the Credit Information Bureau of Sri Lanka (Amendment) Act, No. 42 of 2008, the Monetary Board (MB) shall retain not less than fifteen per centum of the issued share capital of the Bureau. Accordingly MB will retain 19.9 per cent of such shares and excess will be re distributed among the existing state owned members, during the year 2009. As these are held for subsequent disposal, the investment is accounted for under cost method.

The impact from above investments in associates not being accounted for based on equity method, is immaterial.

Notes to be read as Part of the Financial Statements

For the year ended 31 December 2008

9. Investments in Financial and Other Institutions (Continued)

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

	2008 Rs. '000	2007 Rs. '000
Credit Information Bureau Ltd.	15,479	12,135
Lanka Clear (Pvt) Ltd.	29,500	29,500
Fitch Ratings Lanka Ltd.	3,500	3,500
Lanka Financial Services Bureau Ltd.	2,250	5,000
Total Investments in Financial and Other Institutions	50,729	50,135

10. Inventories

	2008 Rs. '000	2007 Rs. '000
Notes for Circulation	1,539,696	1,155,948
Coins for Circulation	440,791	497,949
Coins in Transit	7,739	41,155
	1,988,226	1,695,052
Less: Allowance for Slow Moving Items	(55,300)	(55,300)
	1,932,926	1,639,752
Stationery and Sundry Inventory	28,761	25,596
Total Inventories at Lower of Cost and Net Realisable Value	1,961,687	1,665,348

11. Property, Plant and Equipment

	Land and Buildings Rs. '000	Plant & Plant Integrals Rs. '000	Furniture & Equip- ment Rs. '000	Motor Vehicles Rs. '000	Computer Hardware Rs. '000	Others Rs. '000	Total Rs. '000 2008	Total Rs. '000 2007
At 01 January net of Accumulated Depreciation	8,166,228	780,271	193,868	98,446	61,880	53,954	9,354,647	7,171,183
Additions	11,798	2,961	28,161	-	35,870	120,884	199,674	220,177
Revaluation								2,233,010
Disposals	-	-	(263)	-	(85)	(13,287)	(13,635)	-
Net effect of Reclassification / Written off	-	-	-	-	-	-	-	-
Depreciation charge for the year	(121,064)	(52,575)	(45,097)	(27,033)	(50,435)	(1,495)	(297,698)	(269,722)
At 31 December net of Accumulated Depreciation	8,056,962	730,657	176,669	71,413	47,230	160,056	9,242,988	9,354,648

Notes to be read as Part of the Financial Statements

For the year ended 31 December 2008

11. Property, Plant and Equipment (*Continued*)

	Land and Buildings	Plant & Plant Integrals	Furniture & Equipment	Motor Vehicles	Computer Hardware	Others	Total	Total
	Rs. '000	Rs. '000	Rs. '000	Rs. '000	Rs. '000	Rs. '000	Rs. '000	Rs. '000
							2008	2007
At 31 December								
Gross Carrying Amount								
At cost	21,646	1,051,505	568,467	213,390	699,853	184,870	2,739,731	2,556,914
At revaluation	8,166,968						8,166,968	8,166,968
Accumulated Depreciation								
At cost	(1,402)	(320,848)	(391,798)	(141,977)	(652,623)	(24,814)	(1,533,462)	(1,359,615)
At revaluation	(130,250)						(130,250)	(9,619)
Net Carrying Amount	8,056,962	730,657	176,669	71,413	47,230	160,056	9,242,988	9,354,648

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 31st December 2007.

Composition of Land and Buildings is as follows:

	Carrying Value 2008 Rs. '000	Carrying Value 2007 Rs. '000
Freehold Land	2,839,300	2,839,300
Buildings on Freehold Land	5,149,326	5,264,049
Buildings on Leasehold Land	68,336	62,880
	8,056,962	8,166,229

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.6,765,745 (2007 Rs.6,753,947).

Notes to be read as Part of the Financial Statements

For the year ended 31 December 2008

12. Intangible Assets

	2008 Rs. '000	2007 Rs. '000
Computer Software:		
Cost:		
As at 01 January	464,420	463,149
Additions	20,039	1,271
As at 31 December	484,459	464,420
Amortisation and Impairment:		
As at 01 January	463,467	463,149
Amortisation Charge for the year	5,275	318
As at 31 December	468,742	463,467
Net Book Value:		
As at 01 January	953	-
As at 31 December	15,717	953

13. Amounts Payable to Banks and Financial Institutions

	2008 Rs. '000	2007 Rs. '000
Payable to Foreign Banks	-	6,246,208
Payable to other Foreign Financial Institutions	336,091	484,314
Total Amount Payable to Banks and Financial Institutions	336,091	6,730,522

14. Amounts Payable to the Asian Clearing Union

	2008 Rs. '000	2007 Rs. '000
Payable as at the end of the year	91,354,090	48,454,327

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 0.27% and 3.94% (2007- 4.13% and 5.15%) 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 balance sheet dates.

Notes to be read as Part of the Financial Statements

For the year ended 31 December 2008

15. IMF Related Liabilities

	2008 Rs. '000	2007 Rs. '000
Interest Bearing Loans – Non-Current	7,534,695	18,809,059
Interest Bearing Loans – Current	11,543,903	8,501,764
Allocation of Special Drawing Rights	12,349,883	12,175,406
Other Amounts Payable to IMF	39,987,545	38,417,617
Quota Liability	23,717,632	24,387,543
	87,598,963	83,482,330
Total IMF Related Liabilities	95,133,658	102,291,389

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 per cent per annum. The repayment period given for such loans by IMF is over a maximum period of 10 years.

The reforms undertaken under PRGF would include:

- Continued fiscal consolidation
- Labour market reforms
- Public enterprise restructuring & privatization
- Reform of the public administration
- Removal of impediments to foreign direct investment
- Substantial increase in public expenditure on infrastructure development.

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 per cent per annum. The repayment period given for this loan by IMF is over a period of 10 years with a grace period of 4½ years.

The reforms undertaken under this facility would include:

- Fiscal consolidation
- Reforming the financial sector
- Reforming public enterprises & trade regime
- Labor market regulations
- Strengthening macroeconomic policy instruments & institutions

Notes to be read as Part of the Financial Statements

For the year ended 31 December 2008

15. IMF Related Liabilities (Continued)

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 in emergency assistance for Sri Lanka. The emergency assistance will be repaid in eight equal quarterly instalments over 3¼ to 5 years from the disbursement date.

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

	Effective interest rate %	Maturity	2008 Rs. '000	2007 Rs. '000
Current				
EFF	3.55		1,200,693	1,183,730
EAF	3.55		1,338,014	6,658,479
PRGF 2	0.5		9,005,195	959,555
			11,543,903	8,501,764
Non-Current				
PRGF 2	0.5	2013	4,683,050	5,936,000
EFF	3.55	2010	600,346	1,775,594
EAF	3.55	2010	2,251,299	11,097,465
			7,534,695	18,809,059
Total Interest bearing Loans			19,078,598	27,310,823

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.

Notes to be read as Part of the Financial Statements

For the year ended 31 December 2008

16. 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.

	2008 Rs. '000	2007 Rs. '000
Deposits by Banks :		
– Related Parties	33,347,603	38,250,751
– Others	48,960,685	52,795,434
	82,308,288	91,046,185
Deposits by Financial Institutions :		
– Related Parties	91	64
– Others	2,836	6,775
	2,926	6,839
Total Deposits by Banks and Other Financial Institutions	82,311,214	91,053,024

17. Balances with Government and Governmental Entities - Related Parties

	2008 Rs. '000	2007 Rs. '000
Government Deposits	341,343	642,135
Government Agencies and Funds	904,281	773,940
Total Balances with Government and Governmental Entities	1,245,624	1,416,075

18. Balances with Employee Benefit Plans

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

	2008 Rs. '000	2007 Rs. '000
Employee Provident Fund – Related Party	2,563	713
Employee Retirement Pension Scheme – Related Party	(482,438)	437,867
Widows' / Widowers' & Orphans' Pension Schemes – Related Party	704,166	829,216
Payable in respect of Gratuity	39,337	46,488
Payable in respect of Medical Benefit Scheme	891,433	935,883
Total Other Deposits	1,155,061	2,250,167

Notes to be read as Part of the Financial Statements

For the year ended 31 December 2008

19. Currency in Circulation

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

	2008 Rs. '000	2007 Rs. '000
Demonination		
Coins:		
1 cent	3,631	3,630
2 cent	5,701	5,702
5 cent	23,247	23,248
10 cent	39,217	39,219
25 cent	120,339	120,107
50 cent	182,833	182,026
1 rupee	539,674	521,912
2 rupee	762,381	702,788
5 rupee	2,372,090	2,224,692
10 rupee	405,241	424,424
Other commemorative coins	337,454	334,249
	4,791,808	4,581,997
Notes:		
1 rupee	4,981	4,981
2 rupee	26,700	26,703
5 rupee	37,211	37,222
10 rupee	1,904,330	1,848,928
20 rupee	1,899,290	1,882,440
50 rupee	2,773,091	2,961,861
100 rupee	11,415,696	10,738,048
200 rupee	174,796	772,124
500 rupee	15,693,067	14,964,174
1,000 rupee	93,189,087	95,385,169
2,000 rupee	54,188,857	40,160,075
	181,307,106	168,781,725
Total Currency in Circulation	186,098,914	173,363,722

20. Deferred Grants

As a part of the modernization program, the Bank embarked on three projects; namely Real Time Gross Settlement System (RTGS), Scrip less Security System (SSS) and General Ledger system (GLS). The World Bank funded the projects and the Bank received such financing by way of a grant from the Government of Sri Lanka. The assets were 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. Total value of the grant was Rs.737, 491 and the amount recognized in the income statement (under Other Income) during the year was a zero balance (2007 Rs. 60,007).

21. 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.

Notes to be read as Part of the Financial Statements

For the year ended 31 December 2008

21. Equity (Continued)

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.

Surplus and Control Account Reserve – This comprise the Surplus Reserve and Control Account Reserve. Surplus reserve is a reserve established in accordance with section 39(b) of the Monetary Law Act which requires that the total capital of the CBSL should not be less than 15% of the difference between the total assets of the bank and its assets in gold and foreign currencies. The balance of Rs15,335,205 at 31 December 2008 represents a reserve made to satisfy this requirement in the prior year. The balance of the Control Account Reserve relates to historic surplus and deficit not allocated to other equity reserves.

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 – For the year ended 31 December 2008, unrealized gains and losses on the revaluation of securities designated as available for sale and 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 billion 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.

The movements in the other reserves as follows:

	Capital Contri- bution	Medium and Long Term Credit Reserve	Surplus & Control Account Reserve	CBSL Specific Reserves	RTGS Sinking Fund	IRR	Net Fair Value/(Loss) on Available for Sale Securities	Pension Fund Reserves	Technical Advance- ment Reserves	Total
	Rs.'000	Rs.'000	Rs.'000	Rs.'000	Rs.'000	Rs.'000	Rs.'000	Rs.'000	Rs.'000	Rs.'000
As at 01 January 2008	577,859	9,425,000	31,041,693	322,817	139,570	61,422,435	(781,448)			102,147,926
Transfer of RTGS Income to RTGS Fund					63,294					63,294
Transfer CBSL Specific Reserves				150,377						150,377
Transfer of Profits to General Reserve			11,722,139							11,722,139
Transfer of Net Foreign Exchange Revaluation Gain						(22,810,925)				(22,810,925)
Net Fair Value / (Loss) on Available for Sale Securities							2,603,850			2,603,850
Transfer of Funds from General Reserve to Pension Fund Reserves			(3,000,000)					3,000,000		
Transfer of Funds from General Reserve to Technical Advancement Reserves			(1,000,000)						1,000,000	
Transfer To Reserve Appropriated as Capital	(577,859)		(24,407,141)							(24,985,000)
As At 31 December 2008	-	9,425,000	14,356,691	473,194	202,864	38,611,510	1,822,402	3,000,000	1,000,000	68,891,661

Notes to be read as Part of the Financial Statements

For the year ended 31 December 2008

22. 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. 8,000,000 to the government in respect of 2007.

23. Interest Income from Financial Assets

	2008 Rs. '000	2007 Rs. '000
Interest Income from Foreign Currency Financial Assets		
Cash & Cash Equivalents	4,670,088	5,956,825
Financial Assets	6,3343,568	7,086,382
IMF Related Assets	124,534	169,872
Other Foreign Receivables	-	27,683
Total Interest Income from Foreign Currency Financial Assets	11,129,190	13,240,762
Interest Income from Local Currency Financial Assets		
Investment Portfolio – Sri Lanka Government Securities	6,538,858	9,207,485
Other Loans and Advances	504,173	309,352
Total Net Interest Income from Local Currency Financial Assets	7,043,173	9,516,837
Total Interest Income from Financial Assets	18,172,221	22,757,599

24. Interest Expense on Financial Liabilities

	2008 Rs. '000	2007 Rs. '000
Interest Expense on Foreign Currency Financial Liabilities		
Amount Payable to Asian Clearing Union	869,784	1,330,404
IMF Related Liabilities	428,110	828,181
Securities Sold Under Agreements to Repurchase	-	67,685
Other Foreign Payable	3,658	-
Total Interest Expense on Foreign Currency Financial Liabilities	1,301,552	2,226,270
Interest Expense on Local Currency Financial Liabilities		
Securities Sold under Agreements to Repurchase	511,709	551,596
Total Interest Expense on Local Currency Financial Liabilities	511,709	551,596
Total Interest Expense on Financial Liabilities	1,813,261	2,777,866

Notes to be read as Part of the Financial Statements

For the year ended 31 December 2008

25. Other Income

	2008 Rs. '000	2007 Rs. '000
Dividend Income – Related Party	9,048	12,648
– Others	–	394
Gain on Disposal of Property, Plant & Equipment	1,708	567
Gain on Disposal of Investments in Financial and Other Institutions	308	(12)
Amortisation of Deferred Grant	68	60,007
Miscellaneous Income	443,118	347,792
Total Other Income	454,250	421,396

26. Personnel Expenses

	2008 Rs. '000	2007 Rs. '000
Wages and Salaries including PAYE Tax paid by the Employer	1,718,302	1,591,667
Defined Contribution Plan Costs	215,066	187,834
Post Employee Defined Benefit Plan Costs	1,333,944	1,671,606
Total Personnel Expenses	3,267,312	3,451,107

27. Administration Expenses

	2008 Rs. '000	2007 Rs. '000
Repairs and Maintenance	441,637	341,234
Information	77,242	78,564
Operational Travel	48,532	20,099
Rental Expenses	1,217	1,239
Printing	23,830	23,982
Audit Fees	8,688	9,040
Remuneration to Members of the Monetary Board	383	389
Interest Expense on CBSL Provident Fund	468,165	453,125
Miscellaneous	402,563	245,293
Total Other Operating Expenses	1,472,257	1,172,965

28. Income Tax

As per the Inland Revenue 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. 1,877,740 (2007 – Rs. 984,842) was expensed in relation to such withholding tax, payable on interest income of Rs. 21,441,815 (2007 – Rs. 10,459,706). In addition, the Bank paid Economic Service Charge amounting to Rs. 60,000 in 2008 (2007 – Rs. 60,000).

Notes to be read as Part of the Financial Statements

For the year ended 31 December 2008

29. Reconciliation of Operating Profit with Operating Cash Flow

	2008 Rs. '000	2007 Rs. '000
Reported Net Profit from Operating Activities	(5,044,424)	28,825,385
Add (Subtract) Non-Cash Items		
Depreciation	302,977	270,040
Interest Received – Local Currency – Investment Portfolio	(6,538,858)	(9,131,665)
Provision for Post Employee Defined Benefits Plans	4,682,839	–
Gross Unrealised Foreign Exchange / (Gain) Loss	22,541,075	(8,723,055)
Other Provision	21,329,329	1,943,189
Deferred Grants	(68)	(59,917)
Add (Subtract) Movements in Other Working Capital Items		
(Increase) / Decrease in Inventories	(296,339)	602,189
(Increase) / Decrease in Interest Receivable	1,025,519	(141,746)
Increase / (Decrease) in Miscellaneous Liabilities	(26,755,479)	(2,304,419)
Increase / (Decrease) in Interest Payable	(141,667)	(36,171)
Increase / (Decrease) in Other Receivable	46,997	450,759
Add (Subtract) Investing and Financing Activities		
Income from Investments	–	15,550
Dividend Received	–	(13,041)
Net Unrealised Market Value Changes	(2,211,883)	(4,413,887)
Net Cash Flow From Operating Activities	8,940,018	7,283,211

30. Issues / (Withdrawals) of Circulation Currency on Government Transactions

	2008 Rs. '000	2007 Rs. '000
Maturity of Government of Sri Lanka Investment Portfolio	–	(233,522,233)
Purchases of Government of Sri Lanka Securities for Investment Portfolio	114,186,270	209,516,796
Interest Received – Local Currency – Investment Portfolio	(4,565,637)	(9,021,548)
Increase / (Decrease) in Advances to GOSL	15,253,700	11,663,800
(Increase) / Decrease in Balances with Government and Government Entities	545,151	(59,724)
Deferred Grant Received	–	–
	125,419,484	(21,422,909)

Notes to be read as Part of the Financial Statements

For the year ended 31 December 2008

31. Net Issues / (Withdrawals) of Circulation Currency on Bank and Financial Institutions Transactions

	2008 Rs. '000	2007 Rs. '000
(Increase) / Decrease in Deposits by Banks and Financial Institutions	8,741,810	(8,564,417)
	<u>8,741,810</u>	<u>(8,564,417)</u>

32. Closing Cash & Cash Equivalents

	2008 Rs. '000	2007 Rs. '000
Foreign Currency Assets		
Cash Balances with Other Foreign Banks	167,338,807	160,051,979
Closing Cash & Cash Equivalents	<u>167,338,807</u>	<u>160,051,979</u>

33. Concentrations of Funding

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

	2008 Total Rs. '000	Sri Lanka Govern- ment Rs. '000	Sri Lanka Public Rs. '000	Sri Lanka Commer- cial Banks Rs. '000	Supra- National Financial Institutions Rs. '000	Other Rs. '000
As at 31 December 2008						
Foreign Currency Financial Liabilities						
Amount Payable to Banks and Financial Institutions	336,091	-	-	-	333,703	2,388
Amount Payable to Asian Clearing Union	91,354,909	-	-	-	91,354,909	-
IMF Related Liabilities	95,133,658	-	-	-	95,133,658	-
Other Foreign Payables	1,517,077	-	-	1,453,322	63,755	-
Total Foreign Currency Financial Liabilities	<u>188,341,735</u>	<u>-</u>	<u>-</u>	<u>1,453,322</u>	<u>186,886,025</u>	<u>2,388</u>
Local Currency Financial Liabilities						
Securities Sold Under Agreements to Repurchase	13,743,000	13,743,000	-	-	-	-
Balances with Government and Governmental Entities	1,245,624	1,244,977	647	-	-	432,585
Deposits by Banks and Financial Institutions	82,311,214	-	-	82,308,288	-	2,926
Balances with Employee Benefits Plan	1,155,061	-	-	-	-	1,155,061
Other Payables	1,664,352	242,765	-	-	-	1,421,587
Total Local Currency Financial Liabilities	<u>100,119,251</u>	<u>15,230,742</u>	<u>647</u>	<u>82,308,288</u>	<u>-</u>	<u>3,012,159</u>
Total Financial Liabilities	<u>288,460,986</u>	<u>15,230,742</u>	<u>647</u>	<u>83,761,610</u>	<u>186,886,025</u>	<u>3,014,547</u>
Other Liabilities						
Currency in Circulation	186,098,914	-	186,098,914	-	-	-
Pension and Other Post Employment Benefit Plans	1,026,698	-	-	-	-	1,026,698
Miscellaneous Liabilities and Accruals	531,960	-	-	-	-	531,960
Total Other Liabilities	<u>187,657,572</u>	<u>-</u>	<u>186,098,914</u>	<u>-</u>	<u>-</u>	<u>1,558,658</u>
Total Liabilities	<u>476,118,558</u>	<u>15,230,742</u>	<u>186,099,561</u>	<u>83,761,610</u>	<u>186,886,025</u>	<u>4,573,205</u>

Notes to be read as Part of the Financial Statements

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33. Concentrations of Funding (Continued)

Comparative figures as at 31 December 2007 were as follows.

	2007 Total Rs. '000	Sri Lanka Govern- ment Rs. '000	Sri Lanka Public Rs. '000	Sri Lanka Commer- cial Banks Rs. '000	Supra- National Financial Institutions Rs. '000	Other Rs. '000
As at 31 December 2007						
Foreign Currency Financial Liabilities						
Amount Payable to Banks and Financial Institutions	6,730,522	-	-	-	479,391	6,251,131
Amount Payable to Asian Clearing Union	48,454,327	-	-	-	48,454,327	-
IMF Related Liabilities	102,291,389	-	-	-	102,291,389	-
Other Foreign Payables	1,615,652	-	-	1,396,541	219,111	-
Total Foreign Currency Financial Liabilities	159,091,890	-	-	1,396,541	151,444,218	6,251,131
Local Currency Financial Liabilities						
Deposits by Banks and Financial Institutions	91,053,024	-	-	91,046,185	-	6,839
Balances with Government and Governmental Entities	1,416,075	642,135	773,940	-	-	-
Securities Sold Under Agreements to Repurchase	18,000	18,000	-	-	-	-
Balances with Employee Benefits Plan	2,250,165	-	-	-	-	2,250,165
Other Payables	1,923,545	544,021	-	-	-	1,379,524
Total Local Currency Financial Liabilities	96,660,809	1,204,156	773,940	91,046,185	-	3,636,528
Total Financial Liabilities	255,752,699	1,204,156	773,940	92,442,726	151,444,218	9,887,659
Other Liabilities						
Currency in Circulation	173,363,722	-	173,363,722	-	-	-
Deferred Grants	68	-	-	-	-	68
Pension and Other Post Employment Benefit Plans	324,183	-	-	-	-	324,183
Miscellaneous Liabilities and Accruals	614,604	-	-	-	-	614,604
Total Other Liabilities	174,302,577	-	173,363,722	-	-	938,855
Total Liabilities	430,055,276	1,204,156	174,137,662	92,442,726	151,444,218	10,826,514

34. Risk Management

As the monetary authority of the country, the Central Bank's activities are policy oriented. In the course of carrying out of its functions, the Bank is faced with financial risks, operational risks as well as reputational 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 Bank-Wide Risk Management Committee, co-chaired by the two Deputy Governors, comprises all 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

Notes to be read as Part of the Financial Statements

For the year ended 31 December 2008

34. Risk Management (Continued)

Securities Settlement System (SSS), the General Ledger System and the Treasury Dealing Room Management System (TDRMS) are controlled.

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 assets portfolio. The Middle Office of the IOD is responsible for monitoring and maintaining the Bank's financial risk management framework.

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. The comprehensive set of guidelines incorporating risk mitigation policies have been issued to the dealers involved in the reserves management function.

A Counterparty 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 counterparties. 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 34.1, 34.2, 34.3 & 34.4, 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.

34.1 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.

Concentration of credit exposure in geographical area

	2008 Rs. '000	2007 Rs. '000
Sri Lanka	259,328,320	108,372,625
USA	88,686,431	51,070,475
Japan	706,828	4,979,555
Britain	47,229,703	107,898,024
Europe	72,914,932	119,323,079
Supranational	88,850,454	107,971,080
Other	15,296,937	48,594,045
Total Financial Assets	573,013,605	548,208,883

(b) Concentrations of Credit Exposure

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

	2008 Rs. '000	2007 Rs. '000
Government	281,740,197	206,077,330
Supranational Financial Institutions	88,850,454	107,971,080
Foreign Banks and Financial Institutions	200,437,986	231,413,009
Other	1,984,968	2,747,464
Total Financial Assets	573,013,605	548,208,883

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For the year ended 31 December 2008

34.1 Credit Risk (Continued)

(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 possible credit quality rating and indicates the lowest expectation of credit risk. It is assigned only in the case of exceptionally strong capacity for timely payment of financial commitments. AA is a very high credit 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 the entity has not been rated by Standard and Poor's, Moody's or Fitch.

Aaa* denotes ratings of Moody.

Credit Exposure by Credit Rating

	Credit Rating	2008 Rs. 000	%	2007 Rs. 000	%
Cash & Cash Equivalents					
Federal Reserve Bank - USA/Reserve Bank of Australia/ Bank for International Settlements					
		90,785,318	16%	25,258,663	5%
	AAA	51,512,175	9%	31,506,746	6%
	AA+	-	0%	9,888,920	2%
	AA	644	0%	46,346,647	9%
	AA-	210,637	0%	38,797,846	7%
	A+	16,326	0%	802,633	0%
	A	874,189	0%	823,954	0%
	NR	23,939,518	4%	6,626,570	1%
		167,338,807	29%	160,051,979	30%
Foreign Currency Trading / Available for Sale Securities					
Bank for International Settlements					
		579,885	0%	2,704,099	1%
	AAA/Aaa	77,946,710	14%	151,512,208	28%
	AA+	-	0%	764,818	0%
	AA-	-	0%	3,864,547	1%
	A+	6,244,328	1%	3,597,373	1%
	NR	7,344,237	1%	30,682,013	6%
		92,115,159	16%	193,125,058	36%
IMF Related Assets					
		72,399,875	13%	71,899,462	13%
Other Foreign Receivables					
Bank for International Settlements/Federal Reserve Bank-USA					
		3,621	0%	7,699	0%
	AAA	727,588	0%	110,835	0%
	AA+	-	0%	13,767	0%
	AA	3	0%	80,034	0%
	AA-	652,063	0%	540,987	0%
	A	2,542	0%	338	0%
	NR	42,081	0%	14,213	0%
		1,427,898	0%	767,873	0%
Total Foreign Currency Financial Assets					
		333,281,739	58%	425,844,373	80%
Investments in Gold					
	AAA	10,078,754		-	
Trading Securities denominated in Gold					
	AA-	348,678		13,991,886	
Total Foreign Currency Non-Financial Assets					
		10,427,432		13,991,886	

Notes to be read as Part of the Financial Statements

For the year ended 31 December 2008

34.1 Credit Risk (Continued)

	Credit Rating	2008 Rs. 000	%	2007 Rs. 000	%
Local Currency Financial Assets	BB- NR	237,444,065 2,287,800	41% 1%	105,772,072 2,600,552	20% 0%
Total Local Currency Financial Assets		239,731,865	42%	108,372,625	20%
Total Financial Assets		573,013,604	100%	534,216,997	100%
Summary by Major Credit Category					
Foreign Currency Financial Assets					
Bank for International Settlements/Federal Reserve Bank–USA/ Reserve Bank of Australia IMF related Assets		91,368,824 72,399,875	16% 13%	27,970,461 71,899,462	5% 13%
	AAA/Aaa	130,186,472	23%	183,129,790	34%
	AA+/-	863,349	0%	100,297,565	19%
	A+/-	7,137,386	1%	5,224,298	1%
	NR	31,325,835	5%	37,322,797	7%
Total Foreign Currency Financial Assets		333,281,741	58%	425,844,373	79%
Local Currency Financial Assets					
	BB- NR	237,444,065 2,287,800	41% 1%	105,772,072 2,600,552	20% 1%
Total Local Currency Financial Assets		239,731,865	42%	108,372,623	21%
Total Financial Assets		573,013,606	100%	534,216,997	100%

34.2 Interest Rate Risk

(a) Foreign Currency Interest Rate Sensitivity

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

- a. 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 used by the Bank to measure Sensitivity of the risk exposure of the segmented Fixed Income Securities Portfolio as given below.

Sensitivity Analysis of the segmented Fixed Income Securities portfolio

Portfolio Segment	Potential Loss (US\$ mn)	
	2008	2007
Trading	1.39	3.9
Available for Sale	1.39	2.57
Total	2.78	6.47

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

Notes to be read as Part of the Financial Statements

For the year ended 31 December 2008

34.2 Interest Rate Risk (Continued)

- 1) 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 sets 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 as compared with the upper limits are tabulated below:

Modified Duration 2008			
Investment Segment	Modified Duration		
	As at 31/12/2008	As at 31/12/2007	Upper Limit
Money Market (Fixed and call deposits)	0.04	0.02	0.25
Capital Market (Fixed Income Securities)	3.41	3.72	5
Overall	1.76	2.27	2.5

- 2) 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	2008	2007
Trading	0.18	0.23
Available for Sale	0.23	0.22
Total	0.20	0.23

(b) Local Currency Interest Rate Sensitivity

The local Treasury bills portfolio is recorded in the Balance Sheet of the CBSL at amortised 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.

Notes to be read as Part of the Financial Statements

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34.2 Interest Rate Risk (Continued)

(c) Assets and liabilities will mature or re-price within the following periods.

Foreign Currency Interest Rate Sensitivity Gap:	Weighted Avg. int. Rate, %	2008 Total Rs. '000	< = 6 months Rs. '000	6–12 months Rs. '000	1–2 yrs Rs. '000	2–5 yrs Rs. '000	> 5 years Rs. '000
Interest Sensitive Currency Financial Assets							
Cash & Cash equivalents	0.6	167,338,807	167,338,807				
Securities at Fair Value through Profit and Loss and Available for Sale Investments	3.24	92,115,159	1,040,929	805,633	35,318,189	24,578,371	30,372,038
IMF related assets	2.47	8,560,403	8,560,403				
Total Interest Sensitive Foreign Currency Financial Assets		268,014,369	176,940,139	805,633	35,318,189	24,578,371	30,372,038
Non-Interest Sensitive Foreign Currency Financial Assets							
IMF Related Assets		63,839,472					63,839,472
Receivables		1,427,899	1,427,899				
Total Non-Interest Sensitive Foreign Currency Financial Assets		65,267,371	1,427,899	-	-	-	63,839,472
Total Foreign Currency Financial Assets		333,281,740	178,368,038	805,633	35,318,189	24,578,371	94,211,510
Interest Sensitive Foreign Currency Financial Liabilities							
IMF Related Liabilities	2.59	19,078,598	5,771,951	5,771,951	4,189,660	3,345,036	-
Amounts payable to ACU	1.79	91,354,909	91,354,909				
Total Interest Sensitive Foreign Currency Financial Liabilities		110,433,507	97,126,860	5,771,951	4,189,660	3,345,036	-
Non-Interest Sensitive Foreign Currency Financial Liabilities							
Amounts payable to ACU		262,990	262,990				
IMF Related Liabilities		76,055,059					76,055,059
Commercial Bank Capital in Foreign Currency		1,453,322					1,453,322
Other Foreign Liabilities		136,856	136,856				
Total Non-Interest Sensitive Foreign Currency Financial Liabilities		77,908,227	399,846	-	-	-	77,508,381
Total Foreign Currency Financial Liabilities		188,341,734	97,526,706	5,771,951	4,189,660	3,345,036	77,508,381
Foreign Currency Interest Rate Sensitivity Gap		157,580,862	79,813,279	(4,966,318)	31,128,529	21,233,335	30,372,038

Notes to be read as Part of the Financial Statements

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34.2 Interest Rate Risk (Continued)

Foreign Currency Interest Rate Sensitivity Gap:	Weighted Avg. int. Rate, %	2008 Total Rs. '000	< = 6 months Rs. '000	6–12 months Rs. '000	1–2 yrs Rs. '000	2–5 yrs Rs. '000	> 5 years Rs. '000
Interest Sensitive Local Currency Financial Assets							
Investment portfolio – Sri Lanka							
Government Securities	18.49	142,813,489	55,673,224	87,140,265			
Reverse Repos	12.5	13,204,000	13,204,000				
Loans to Other Institutions	3	1,577,301	210,537	199,976	358,909	789,595	18,284
Other assets	13.1	1,364,690	511,512	22,346	11,163		
Total Interest Sensitive Local Currency Financial Assets		158,959,480	69,599,273	87,362,587	370,072	789,595	18,284
Non-Interest Sensitive Local Currency Assets							
Interest receivable on Govt. Securities		3,754,186	2,017,619	1,736,567			
Loans to Government		76,307,700	76,307,700				
Receivables		659,770	659,770				
Investment in Equity		50,729					50,729
Other Assets		13,626,313	13,626,313				
Total Non-Interest Sensitive Local Currency Assets		94,398,698	92,611,402	1,736,567	–	–	50,729
Total Local Currency Assets		253,358,178	162,210,675	89,099,154	370,072	789,595	69,013
Interest Sensitive Local Currency Financial Liabilities							
Securities Sold under Agreement to Repurchase	10.50	13,743,000	13,743,000				
Total Interest Sensitive Local Currency Financial Liabilities		13,743,000	13,743,000	–	–	–	–
Non-Interest Sensitive Local Currency Liabilities							
Balance with Banks and Financial Institutions		82,311,214	82,311,214	–	–	–	–
Balances with Government and Government Entities		1,245,624	1,245,624	–	–	–	–
Balances with Employee Benefit Plans		1,155,061	1,155,061	–	–	–	–
Other Deposits & Payables		1,664,353	1,664,353	–	–	–	–
Other Liabilities		187,657,572	187,657,572	–	–	–	–
Total Non-Interest Sensitive Local Currency Financial Liabilities		274,033,824	274,033,824	–	–	–	–
Total Local Currency Liabilities		287,776,824	287,776,824	–	–	–	–
Local Currency Interest Rate Sensitivity Gap		145,216,480	55,856,273	87,362,587	370,072	789,595	18,284

Notes to be read as Part of the Financial Statements

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34.2 Interest Rate Risk (Continued)

Comparative figures as at 31 December 2007 were as follows.

	Weighted Avg. int. Rate, %	2007 Total Rs. '000	< = 6 months Rs. '000	6–12 months Rs. '000	1–2 yrs Rs. '000	2–5 yrs Rs. '000	> 5 years Rs. '000
Foreign Currency Interest Rate Sensitivity Gap:							
Interest Sensitive Foreign Currency Financial Assets							
Cash & Cash Equivalents	4.51	160,051,979	160,051,979	–	–	–	–
Foreign Currency Trading / Available for Sale Securities	44.55	193,125,058	3,961,145	33,305,047	1,791,661	77,836,756	76,230,449
IMF Related Assets	3.33	8,961,903	8,961,903	–	–	–	–
Total Interest Sensitive Foreign Currency Financial Assets		362,138,940	172,975,027	33,305,047	1,791,661	77,836,756	76,230,449
Non-Interest Sensitive Foreign Currency Financial Assets							
Gold		13,991,886	13,991,886	–	–	–	–
IMF Related Assets		62,937,560	–	–	–	–	62,937,560
Receivables		767,873	767,873	–	–	–	–
Total Non-Interest Sensitive Foreign Currency Financial Assets		77,697,319	14,759,759	–	–	–	62,937,560
Total Foreign Currency Financial Assets		439,836,259	187,734,786	33,305,047	1,791,661	77,836,756	139,168,009
Interest Sensitive Foreign Currency Financial Liabilities							
IMF Related Liabilities	3.27	27,310,823	2,811,358	5,690,406	11,380,812	6,768,691	659,556
Amounts Payable to ACU	4.13	48,454,327	48,454,327	–	–	–	–
Total Interest Sensitive Foreign Currency Financial Liabilities		75,765,150	51,265,685	5,690,406	11,380,812	6,768,691	659,556
Non-Interest Sensitive Foreign Currency Financial Liabilities							
Payables		6,730,521	6,730,521	–	–	–	–
IMF Related Liabilities		74,980,566	–	–	–	–	74,980,566
Commercial bank capital in Foreign Currency		1,396,541	–	–	–	–	1,396,541
Other Foreign Liabilities		219,111	219,111	–	–	–	–
Total Non-Interest Sensitive Foreign Currency Financial Liabilities		83,326,739	6,949,632	–	–	–	76,377,107
Total Foreign Currency Financial Liabilities		159,091,889	58,215,316	5,690,406	11,380,812	6,768,691	77,036,663
Foreign Currency Interest Rate Sensitivity Gap		286,373,790	121,709,342	27,614,641	(9,589,151)	71,068,065	75,570,893

Notes to be read as Part of the Financial Statements

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34.2 Interest Rate Risk (Continued)

	Weighted Avg. int. Rate, %	2007 Total Rs. '000	< = 6 months Rs. '000	6-12 months Rs. '000	1-2 yrs Rs. '000	2-5 yrs Rs. '000	> 5 years Rs. '000
Interest Sensitive Local Currency							
Financial Assets							
Investment Portfolio – Sri Lanka							
Government Securities	17.25	41,831,219	41,831,219	-	-	-	-
Loans to Other Institutions	3	2,093,651	287,254	270,233	462,223	1,073,940	-
Other Assets	16.71	1,230,688	273,247	346,768	610,673	-	-
Total Interest Sensitive Local Currency Financial Assets		45,155,558	42,391,720	617,001	1,072,896	1,073,940	-
Non-Interest Sensitive Local Currency Assets							
Interest Receivable on							
Government Securities		1,780,965	1,780,965	-	-	-	-
Advances to Government Receivables		60,679,200	60,679,200	-	-	-	-
		706,767	706,767	-	-	-	-
Investments Securities		50,135	50,135	-	-	-	-
Other Assets		13,235,760	13,235,760	-	-	-	-
Total Non-Interest Sensitive Local Currency Assets		76,452,827	76,452,827	-	-	-	-
Total Local Currency Assets		121,608,385	118,844,547	617,001	1,072,896	1,073,940	-
Interest Sensitive Local Currency Financial Liabilities							
Securities Sold under Agreements to Repurchase							
	10.5	18,000	18,000	-	-	-	-
Total Interest Sensitive Local Currency Financial Liabilities		18,000	18,000	-	-	-	-
Non Interest Sensitive Local Currency Liabilities							
Balance with Banks and F inancial Institutions							
		91,053,024	91,053,024	-	-	-	-
Balances with Government and Governmental Entities							
		1,416,075	1,416,075	-	-	-	-
Balances with Employee Benefit Plans							
		2,250,165	2,250,165	-	-	-	-
Other Deposits and Payables							
		1,923,546	1,923,546	-	-	-	-
Other Liabilities							
		174,302,577	175,869,500	-	-	-	-
Total Non-Interest Sensitive Local Currency Liabilities		270,945,387	272,512,310	-	-	-	-
Total Local Currency Liabilities		270,963,387	272,530,310	-	-	-	-
Local Currency Interest Rate Sensitivity Gap		45,137,558	42,373,720	-	-	-	-

Notes to be read as Part of the Financial Statements

For the year ended 31 December 2008

34.3 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 the Foreign Reserves Management Committee have set percentage holdings of different currencies in its International Reserves. In deciding on the currency allocation, public debt repayment requirements and rate of return of the currency are given due consideration. Accordingly, the Bank holds most of the major currencies such as US Dollars, Sterling Pounds, Euro and Japanese Yen. Compliance with limits established for foreign currency positions is monitored.

Net Exposure to foreign currencies

As at 31 December 2008, the Central Bank of Sri Lanka's net exposure to major currencies was as follows.

	Currency Denomination							Total
	US Dollars	Euro	Yen	Sterling Pounds	SDR	Australian Dollars	Other Currencies	All Currencies
	Rs. '000	Rs. '000	Rs. '000	Rs. '000	Rs. '000	Rs. '000	Rs. '000	Rs. '000
As at 31 December 2008								
Foreign Currency Financial Assets								
Cash & Cash Equivalents	102,261,905	19,813,147	706,828	40,088,541		3,775,039	693,346	167,338,807
Securities at Fair Value through Profit and Loss and Available for Sale Investments	5,996,334	39,036,431		20,070,370		27,012,024		92,115,159
IMF Related Assets					72,399,875			72,399,875
Other Foreign Receivables	23,293	1,311,808	-	-	17,564		75,234	1,427,899
Total Foreign Currency Financial Assets	108,281,532	60,161,386	706,828	60,158,911	72,417,439	30,787,063	768,580	333,281,740
Proportion	32%	18%	0%	18%	22%	9%	0%	100%

Notes to be read as Part of the Financial Statements

For the year ended 31 December 2008

34.3 Foreign Currency Risk (Continued)

	Currency Denomination							Total
	US Dollars	Euro	Yen	Sterling Pounds	SDR	Australian Dollars	Other Currencies	All Currencies
	Rs. '000	Rs. '000	Rs. '000	Rs. '000	Rs. '000	Rs. '000	Rs. '000	Rs. '000
Foreign Currency Financial Liabilities								
Amount Payable to Banks and Financial Institutions	336,091							336,091
Amount Payable to Asian Clearing Union	91,354,909							91,354,909
IMF Related Liabilities					95,133,658			95,133,658
Commercial Banks – Capital Deposits in Foreign Currency	1,517,077							1,517,077
Total Foreign Currency Financial Liabilities	93,208,077				95,133,658	-		188,341,735
Proportion	49%	0%	0%	0%	51%	0%	0%	100%
Net Foreign Currency Exposure	15,073,455	60,161,386	706,828	60,158,912	(22,716,218)		31,555,643	144,940,005

As at 31 December 2007, the Central Bank of Sri Lanka's net exposure to major currencies was as follows.

	Currency Denomination							Total
	US Dollars	Euro	Yen	Sterling Pounds	SDR	Australian Dollars	Other Currencies	All Currencies
	Rs. '000	Rs. '000	Rs. '000	Rs. '000	Rs. '000	Rs. '000	Rs. '000	Rs. '000
As as 31 December 2007								
Foreign Currency Financial Assets								
Cash & Cash Equivalents	121,822,574	22,054,256	802,633	9,971,605		4,259,648	1,141,263	160,051,979
Securities at Fair Value through Profit & Loss and Available for Sale Investments	79,705,056	45,540,693		51,091,773		16,787,536		193,125,058
Securities Denominated in Gold	13,991,886	-	-	-	-		-	13,991,886
IMF Related Assets					71,899,462			71,899,462
Other Foreign Receivables	196,568	497,237	-	8,956	25,526		39,587	767,874
Total Foreign Currency Financial Assets	215,716,084	68,092,186	802,633	61,072,334	71,924,988	21,047,184	22,228,032	439,836,259
Proportion	49.04%	15.48%	0.18%	13.89%	16.35%	4.79%	5.06%	100%

Notes to be read as Part of the Financial Statements

For the year ended 31 December 2008

34.3 Foreign Currency Risk (Continued)

	Currency Denomination							Total
	US Dollars	Euro	Yen	Sterling Pounds	SDR	Australian Dollars	Other Currencies	All Currencies
	Rs. '000	Rs. '000	Rs. '000	Rs. '000	Rs. '000	Rs. '000	Rs. '000	Rs. '000
Foreign Currency Financial Liabilities								
Payables	230,617	5,286,907	–	898	252,602		959,498	6,730,522
Amounts Payable to Asian Clearing Union & Other	48,454,327							48,454,327
IMF Related Liabilities					102,291,389			102,291,389
Other Foreign Liabilities	219,111						–	219,111
Commercial Banks – Capital Deposits in Foreign Currency	1,396,541							1,396,541
Total Foreign Currency Financial Liabilities	50,300,596	5,286,907	–	898	102,543,991		959,498	159,091,889
Proportion	32%	3%	0%	0%	64%		1%	100%
Net Foreign Currency Exposure	165,415,488	62,805,280	802,633	61,071,437	(30,619,003)		21,268,534	280,744,370

34.4 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 as well. 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

	Carrying amount		Fair Value	
	2008	2007	2008	2007
	Rs '000	Rs '000	Rs '000	Rs '000
Fair values				
Cash & Cash Equivalents	167,338,807	160,051,979	167,338,807	160,051,979
Foreign Currency Trading / Available for Sale Securities	92,115,159	193,125,059	92,115,159	193,125,059
IMF Related Assets	72,399,875	71,899,462	72,399,876	71,899,462
Other Foreign Receivables	1,427,899	277,145	1,427,899	277,145
	333,281,740	544,650,811	333,281,741	547,718,156

Notes to be read as Part of the Financial Statements

For the year ended 31 December 2008

34.4 Liquidity Risk (Continued)

	Carrying amount		Fair Value	
	2008 Rs '000	2007 Rs '000	2008 Rs '000	2007 Rs '000
Financial Liabilities				
Amounts payable to Banks & Financial Institution	336,091	6,730,522	336,091	6,730,522
IMF related liabilities	95,133,658	102,291,389	95,133,657	102,291,389
Amounts payable to ACU	91,354,909	48,454,327	91,354,909	48,454,327
Other foreign payables	1,517,077	1,615,652	1,517,077	1,615,652
Total Financial Liabilities	188,341,735	159,091,890	188,341,734	159,091,890
Investment in Gold				
Investments in Gold	10,078,754	–	10,078,754	–
Trading Securities denominated in Gold	348,678	13,991,886	348,678	13,991,886
Total Foreign Currency Non Financial Assets	10,427,432	13,991,886	10,427,432	13,991,886

(b) In order to reduce the level of liquidity risk arising out of the local currency activities, particularly open market operations, the Bank uses highly liquid marketable instruments such as Treasury bills and Treasury bonds as collateral. It manages the daily liquidity position of the banking system by way of infusing or withdrawal of funds from /into the system, such as securities.

35. 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.

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.

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.

Notes to be read as Part of the Financial Statements

For the year ended 31 December 2008

35. Pension and Other Post Employment Benefit Plans (Continued)

The total present value of all benefit obligations exceeds the fair value of plan assets representing a funding gap of Rs. 2,031,226 as at the year end (2007 – Rs. 3,036,903).

2008

	Employee Retirement Pension Scheme Rs. '000	Widows' and Orphans' Pension Scheme Rs. '000	Widowers' and Orphans' Pension Scheme Rs. '000	Gratuity Scheme Rs. '000	Medical Benefit Scheme Rs. '000	Total 2008 Rs. '000
Benefit Liability / (Asset)						
Present Value of Benefit Obligation	15,847,675	3,643,074	1,110,636	43,194	866,162	21,510,741
Fair Value of Plan Assets	(13,928,786)	(3,407,239)	(986,792)	(50,552)	(1,106,147)	(19,479,515)
Unrecognised net Actuarial Gains / (Losses)	(538,718)	(443,232)	(179,842)	3,307	153,957	(1,004,528)
Benefit Liability/ (Asset) non-current	1,380,172	(207,397)	(55,999)	(4,051)	(86,028)	1,026,698
Movement in the Benefit Liability / (Asset)						
At 01 January 2008	732,154	(247,154)	(78,927)	(7,925)	(73,967)	324,182
Benefit Expense	908,051	39,757	22,928	3,874	(12,061)	962,550
Contribution Paid	(260,034)	-	-	-	-	(260,034)
At 31 December 2008 – Non-Current	1,380,172	(207,397)	(55,999)	(4,051)	(86,028)	1,026,698
Benefit Expense						
Interest Cost on Benefit Obligation	1,121,626	238,553	69,038	2,660	61,191	1,493,067
Expected Return on Plan Assets	(902,112)	(224,217)	(62,297)	(3,421)	(73,252)	(1,265,299)
Net Actuarial (Gain) / Loss recognized during the year	457,705	24,045	15,349	-	-	497,100
Transitional Adjustment	-	-	-	-	-	-
Net Current Service Cost	230,832	1,376	838	4,635	-	237,682
Net Benefit Expense	908,051	39,757	22,928	3,874	(12,061)	962,550
Actual Return on Plan Assets	2,386,690	536,912	158,574	8,213	185,968	3,276,357
Changes in Fair Value of Plan Assets						
Fair Value of Plan Assets at the beginning of the year	12,028,159	2,989,565	830,632	45,608	976,689	16,870,653
Actual Return on Plan Assets	2,386,690	536,912	158,574	8,213	185,968	3,276,357
Contribution Received	260,034	16,679	7,346	-	-	284,059
Benefits Paid	(746,097)	(135,917)	(9,759)	(3,269)	(56,511)	(951,553)
Fair value of Plan Assets at the end of the year	13,928,786	3,407,239	986,792	50,552	1,106,147	19,479,515

Notes to be read as Part of the Financial Statements

For the year ended 31 December 2008

35. Pension and Other Post Employment Benefit Plans (Continued)

2007

	Employee Retirement Pension Scheme Rs. '000	Widows' and Orphans' Pension Scheme Rs. '000	Widowers' and Orphans' Pension Scheme Rs. '000	Gratuity Scheme Rs. '000	Medical Benefit Scheme Rs. '000	Total 2007 Rs. '000
Benefit Liability						
Present Value of Benefit Obligation	14,955,007	3,180,708	920,502	35,463	815,876	19,907,556
Fair Value of Plan Assets	(12,028,159)	(2,989,565)	(830,632)	(45,608)	(976,689)	(16,870,653)
Unrecognised net Actuarial Gains /(Losses)	(2,194,694)	(438,297)	(168,797)	2,220	86,847	(2,712,721)
Benefit Liability non-current	732,154	(247,154)	(78,927)	(7,925)	(73,966)	324,182
Movement in the Benefit Liability						
At 1 January 2007	533,998	110,821	37,183	6,337	433,480	1,121,818
Benefit Expense	2,180,512	129,264	44,132	4,895	32,511	2,391,314
Contribution Paid	(1,982,356)	(487,238)	(160,241)	(19,157)	(539,958)	(3,188,950)
At 31 December 2007 - non-current	732,154	(247,153)	(78,927)	(7,925)	(73,967)	324,182
Benefit Expense						
Interest Cost on Benefit Obligation	1,075,458	227,412	63,937	2,267	60,622	1,429,696
Expected Return on Plan Assets	(714,146)	(171,839)	(44,613)	(1,791)	(28,111)	(960,500)
Net Actuarial (Gain) / Loss Recognized during the year	1,510,285	50,909	22,241	-	-	1,583,435
Transitional Adjustment	81,004	21,485	1,780	-	-	104,269
Net current Service Cost	227,912	1,297	787	4,419	-	234,415
Over/(Under) provision in Pension Cost	(1,010,907)	243,588	85,016	(4,895)	(32,511)	(719,709)
Net benefit expense	1,169,606	372,852	129,148	-	-	1,671,606
Changes in Fair Value of Plan Assets						
Fair value of Plan Assets at the beginning of the year	9,521,945	2,291,191	594,838	23,886	374,809	12,806,669
Actual Return on Plan Assets	1,203,285	310,867	76,490	5,562	102,298	1,698,502
Contribution Received	1,982,356	504,746	167,993	19,157	539,958	3,214,210
Benefits Paid	(679,427)	(117,239)	(8,689)	(2,997)	(40,376)	(848,728)
Fair Value of Plan Assets at the end of the year	12,028,159	2,989,565	830,632	45,608	976,689	16,870,653

Notes to be read as Part of the Financial Statements

For the year ended 31 December 2008

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

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

	<u>2008</u>	<u>2007</u>
Discount Rate	10.00%	7.50%
Expected Rate of Return on Assets	7.50%	7.50%
Future Salary Increases	8.50%	6.00%
Future Pension Increases	6.50%	5.00%
Average Remaining years of Service of employees in the following schemes		
CBSL Pension	2 Years	2 Years
W & OP Pension scheme	5 Years	5 Years
WR & OP Pension scheme	5 Years	5 Years
Gratuity scheme	15 Years	15 Years
CBSL Medical Benefit scheme	8 Years	8 Years
Retirement Age	60 years	60 years

36. Financial Instruments

Fair Value of Financial Instruments

The fair value of a 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 2008 was Rs. 13,743,000 (2007 – Rs.18,000).

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.

Assets Pledged

In order to facilitate the securities settlement process, Rs.6,788,388 (USD 60,000) [2007 - Rs. 6,523,164 (USD 60,000)] worth of securities (nominal value) have been pledged by the Bank to the Euroclear Bank and obtained a credit facility of Rs.3,959,893 (USD 35,000) [2007 - Rs. 3,805,179 (USD 60,000)]. The pledged securities are held in a separate account at the Euroclear.

Notes to be read as Part of the Financial Statements

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37. Related Parties

37.1 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	2008	2007
	Rs. '000	Rs. '000
Investment portfolio of Sri Lanka Government securities held by CBSL, as at 31 December (a)	159,771,674	43,612,184
Cost of printing currency notes, for the year ended 31 December (d)	817,910	–
Guarantees provided by CBSL, as at 31 December (Note 38)	898,129	1,091,991
Funds collected in respect of Exchange Control Activities, during the year ended 31 December (e)	16,890	13,997
Goods, Services and Taxes, during the year ended 31 December (f)	638,947	440,710
Paid Surplus to Government, during the year ended 31 December (Note 22)	8,000,000	4,000,000
Advances to Government, as at 31 December (Note 7)	76,307,700	60,679,200
Government Securities held for specific purposes	1,364,690	1,230,687
Gross foreign exchange transactions during the year, (h)		
– Sales	173,314,334	77,843,000
– Purchases	76,267,539	64,471,000
Refinances (j)	6,799,669	1,501,024

(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 2008 are given in Note 16 and 17. Interest earned on the investment portfolio is given in Note 23.

(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 2008, 2 licensed commercial banks and 13 licensed specialized 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.

Notes to be read as Part of the Financial Statements

For the year ended 31 December 2008

37.1 Transactions with State and State Controlled Entities (*Continued*)

- (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.
- (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 39.
- (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 was levied.
- (j) The Bank provides refinance loans and for which credit guarantees also provided as described in Note 38.2.

37.2 Transactions with entities where action is taken under Section 30(1) of the MLA

In December 2008, under provisions of section 30(1) of the MLA, the CBSL has taken action with respect to a financial institution which was encountering liquidity problems, in view of its systematic importance. Such transactions are disclosed in Note 39 (f) to these financial statements.

37.3 Transactions with Other Entities in which the Bank has Significant Investments

During the year the Bank received an amount of Rs. 9,048 (2007 – Rs. 12,648) as dividend income from investments it has in Associates given in Note 9.

37.4 Transactions with Key Managerial Personnel (present and former)

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:

Compensation to the Key Management Personnel :

	2008 Rs. '000	2007 Rs. '000
Short Term Employee Benefits	<u>47,136</u>	<u>41,930</u>

Notes to be read as Part of the Financial Statements

For the year ended 31 December 2008

37.5 Transactions with Post Employment Benefit Plans

	2008 Rs. '000	2007 Rs. '000
Contributions paid and payable	<u>16,440</u>	<u>2,538</u>

The Bank contributed various amounts to Pension and Other Post Retirement Plans as disclosed in Note 35 and Rs.190,927 (2007 – Rs.166,587) to Employees Provident Fund and Rs.468,165 as interest subsidy (2007 – Rs.453,125). 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 18.

37.6 Other Transactions with Key Management Personnel

	2008 Rs. '000	2007 Rs. '000
Loans to Key Management Personnel	<u>4,426</u>	<u>4,231</u>

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

38. Contingent Liabilities and Capital Commitments

38.1 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. Details of such outstanding guarantees as at 31 December 2008 are as follows:

Guarantees in favour of;	Currency of Guarantee	Outstanding Guarantee Amount	
		2008 Rs. '000	2007 Rs. '000
(a) French Treasury- In respect of France Sri Lanka Financial Agreement of 1970, where the GOSL has obtained loans to be utilized for financing the purchase in France of equipment and raw material, intermediate goods, implements spare parts and other goods. This guarantee expired in 2008.	French Franc/ Euro	–	28,970
(b) Banque Indosuez -Stockholm and Nordbanken AB – in respect of currency transfer guarantee under Swedish Credit Agreement of April 1996 in connection with the Anuradhapura Grid Substation power project. This guarantee expired in 2008.	Norwegian Kroner	–	16,021
Total Financial Guarantee Contracts		–	44,991

Notes to be read as Part of the Financial Statements

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38.2 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	
		2008 Rs. '000	2007 Rs. '000
Related Parties	Rupees	898,129	1,047,000
Others	Rupees	1,841,706	2,143,997
Total Credit Guarantees		2,739,835	3,190,997

38.3 Guarantee under Deposit Insurance

Bank administers the Deposit Insurance Scheme which is a voluntary deposit insurance scheme open to banking institutions licensed by the CBSL and co-operative societies registered under the Cooperative Societies Law, No. 5 of 1972 which carry on banking business. As at 31 December the Bank has guaranteed deposits of one entity amounting to Rs.880,352. (2007 – Rs. 772,704) which continued to pay premia to qualify for this scheme.

38.4 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.

38.5 Legal Claims

The Bank is a defendant in various legal actions instituted by stakeholders of entities involved claiming Rs. 57.8 Mn with legal interest. The 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 at 31 December 2008. No provision has been made, as the Bank is of the opinion that it is unlikely that any significant loss will arise.

Notes to be read as Part of the Financial Statements

For the year ended 31 December 2008

38.6 Commitments

As at 31 December 2008 the Bank has commitments of Rs.41,296 (2007 – Rs.893,892), in respect of acquisition of Property, Plant and Equipment.

39. Trust and Custodial Activities

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

- (a) 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 counterparty 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 monies collected under the Compulsory Savings Act, No. 6 of 1971, and the Ceiling of Income and Compulsory Savings Law, No. 15 of 1972 and administers the Compulsory Savings Fund on behalf of the GOSL.
- (c) 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.
- (d) Bank administers the Deposit Insurance Scheme, which is 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.
- (e) 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.
- (f) Transactions with entities where action is taken under Section 30(1) of the MLA

Temporary Liquidity Facility

Maintenance of financial stability is one of the core objectives of the CBSL. Hence, in December 2008, under provisions of section 30(1) of the MLA, the CBSL has taken action with respect to one LCB which was encountering liquidity problems, in view of its systematic importance. The CBSL has provided a liquidity facility to this LCB in the form of Swaps amounting to a total of USD 18 million. As at the end of the year Rs. 17,766,815 (2007 – Rs. 7,918,646) was receivable from this LCB.

40. Events Occurring Subsequent to Balance Sheet Date

A swap facility for USD 200 mn was arranged in February 2009 with a foreign central bank.

Other than for the above, there were no material events occurring subsequent to balance sheet date that require adjustment or disclosure in the financial statements.