

PART II

ACCOUNTS AND OPERATIONS OF THE CENTRAL BANK OF SRI LANKA

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Report of the Auditor General

CENTRAL BANK OF SRI LANKA Monetary Board Advisory Audit Committee Report

The Monetary Board Advisory Audit Committee (AC) appointed by the Monetary Board of the Central Bank of Sri Lanka (CBSL) consisted of three Members: Mr. N A Umagiliya, the Appointed Member of the Monetary Board (Chairman of AC), Mr. M R Mihular (Partner KPMG Ford, Rhodes Thorton & Co) and Mrs. A M J Patrick (Partner SJMS Associates). Dr. W M Hemachandra, Assistant Governor, functioned as the Secretary to the Committee during 2011.

During the financial year 2011 the AC met 8 occasions and carried out the following tasks:

- Reviewing the draft final accounts of CBSL for 2010 prior to signing off by auditors & agree on certain disclosures.
- Following up issues highlighted by the External Auditors (Ernst & Young) in their Interim Issues Memorandum (IIM) and Management Letter (ML) on the 2010 accounts of the CBSL.
- Recommending the following in relation to IIM and ML issues raised:
 - Disclosure of the activities of the mandatory lending for agriculture scheme under the trust and custodial activities in the financial statements of the CBSL and to standardise terms and conditions provided with the operating instructions.
 - Obtain the details of the total payable balances on abandoned property liability inclusive of interest due from the respective licensed banks and finance companies at the end of each financial year to record as a liability of the CBSL.
 - Accounting for funds initially transferred to Sri Lanka Deposit Insurance Scheme.
 - Expand the disclosure note on the trust and custodial activities of the CBSL to include all funds administered through Regional Development Department (RDD) including the nature of the scheme, rights and obligations of each party to the agreements, tax implications, any warranties and assurances undertaken by the CBSL and any special features attributable to the schemes.
 - Record market value of these securities borrowed and unutilized for repurchase operations as a contingent liability arising from securities borrowings.
 - Record the retirement benefit liabilities at the actuarial valued amounts.
 - Adhere to control procedures put in place over manual counting of currencies in the destruction process.
 - Implement a procedure to identify interest receivable on odd dated coupon bonds as at the reporting date and make adjustments for any material differences between the system and manual calculations.
 - Rectify the unadjusted difference between the Gold value as per Treasury Dealing Room Management System (TDRMS) and the General Ledger System (GL) of Rs. 25 mn and to write off any unreconciled balance.
 - Maintain documentation in test scripts in a separate test library for Currency Movement Management System and to take necessary action to adhere to maintaining of Change Request forms in the Asian Clearing Union (ACU) system, as and when required.
- Agreeing with Ernst & Young on the issues encountered in the audit for 2010 in the areas of related party identification and disclosure of balance of Rs. 2.3 bn receivable from government as related party transactions.
- Instructing Chief Accountant to prepare a documented policy for identification of related parties of the CBSL.
- Reviewing and coming to an agreement on the CBSL management's rationale for Lloyed Building and Sovereign Residence properties to be accounted as Property, Plant and Equipment (PPE) instead of Investment Property (IP).
- Reviewing completeness of recording the financial effects of all the funds managed by different departments of the CBSL on the financial statements of the CBSL.
- Making recommendations to periodically review the functionalities of all technical systems of the Bank and reviewing the report from the Information Technology (IT) Department on the post implementation review of software used in the Bank.
- Discussing with Ernst & Young and agreeing on the accounting procedure in relation to the issues on Market valuation of open position; Forex deals, Accounting for derivative options (gold), Presentation of sterilization cost, Change of basis of forex deal matching to day average of transactions, Amortization of premium/discount on fixed income securities, Capitalization of cost of buildings at Somawathiya and Accounting for building purchased in New York.
- Instructing Director Management Audit Department (DMA) to communicate of a specific timeframe for providing replies and implementations of audit proposals, to all the auditees and to review and report to AC of the progress of implementation of his proposals.
- Following up on recommendations made in the Quality Assessment Review Report prepared by Columbus Advisory Services sdn bhd together with the Institute of Internal Auditors (IIA), Malaysia on the Management Audit Department for status of recommendation implementation.
- Making recommendations on the quarterly progress reports of DMA.
- Instructing DMA to provide the Progress Reports with an indication of the level of risk associated with each of his observations.
- Approving the Strategic Audit Plan for 2011-2014 and the Operational Audit Plan for 2011 presented by DMA.
- Reviewing the progress of appointing the External Auditor for the year 2011.
- Reviewing the Audit Plan - 2011 of Ernst & Young.

Central Bank Of Sri Lanka

Management Statement

For the period ended 31 December 2011

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

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

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

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

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

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



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கணக்காய்வாளர் தலைமை அபிபதி திணைக்களம்



AUDITOR GENERAL'S DEPARTMENT

මගේ අංකය } EF/J/CB/FA/2011
எனது இல }
My No. }

ඔබේ අංකය }
உமது இல }
Your No. }

දිනය } 21 March 2012
திகதி }
Date }

Report of the Auditor General on the Financial Statements of the Central Bank of Sri Lanka for the year ended 31 December 2011 in terms of Section 42 (2) of the Monetary Law Act (Chapter 422)

The audit of financial statements of the Central Bank of Sri Lanka for the year ended 31 December 2011 comprising the balance sheet as at 31 December 2011 and the income statement, statement of comprehensive income, statement of changes of equity and statement of cash flows for the year then ended and a summary of significant accounting policies and other explanatory information was carried out under my direction in pursuance of provisions in Article 154(1) of the Constitution of the Democratic Socialist Republic of Sri Lanka read in conjunction with Section 13(1) of the Finance Act, No.38 of 1971 and Section 42 (2) of the Monetary Law Act, (Chapter 422). The audit of financial statements of the CBSL with regard to the compliance of International Financial Reporting Standards had been carried out by a firm of Chartered Accountants in public practice appointed by me.

1.2 Management's Responsibility for the Financial Statements

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

1.3 Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. Sub-sections (3) and (4) of the Section 13 of the Finance Act, No.38 of 1971 give discretionary powers to the Auditor General to determine the scope and extent of the Audit.

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

2. Financial Statements

2.1 Opinion

In my opinion, the financial statements give a true and fair view of the financial position of the Bank as at 31 December 2011, and its financial performance and its cash flows for the year then ended in accordance with International Financial reporting Standards.


H.A.S.Samaraweera
Auditor General

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Central Bank of Sri Lanka
Statement of Financial Position
As at 31 December 2011

	Note	2011 Rs. 000	2010 Rs. 000
Assets			
Foreign Currency Financial Assets			
Cash & Cash Equivalents		303,538,372	189,664,726
Derivative Financial Instruments	5	2,794,334	-
Financial Assets:			
- Securities at Fair Value through Profit & Loss	6	92,856,165	183,729,813
- Available for Sale Investments	6	270,664,801	346,935,603
Unallocated Gold		13,150,196	1,886,602
Other Foreign Receivables		19,375,161	8,534,829
IMF Related Assets	7	73,090,517	71,199,269
Total Foreign Currency Financial Assets		775,469,546	801,950,842
Local Currency Financial Assets			
Investment Portfolio - Sri Lanka Government Securities		183,885,564	20,497,816
Advances to Government	8	94,743,013	77,878,823
Loans to other Institutions	9	2,313,533	2,459,846
Other Local Receivables		2,924,028	3,274,892
Investments in Financial and Other Institutions	10	41,211	41,236
Other Assets		4,695,913	3,701,186
Total Local Currency Financial Assets		288,603,262	107,853,799
Total Financial Assets		1,064,072,808	909,804,641
Foreign Currency Non-Financial Assets			
Allocated Gold		43,819,156	52,120,605
Local Currency Non-Financial Assets			
Inventories	11	2,484,681	2,814,784
Sundry Assets		1,980,518	1,741,512
Property, Plant and Equipment	12	9,996,697	9,344,340
Intangible Assets	13	13,723	17,753
Pension and other Post Employment Benefit Plans	40	991,571	869,700
Total Other Assets		59,286,346	66,908,694
Total Assets		1,123,359,154	976,713,335
Liabilities and Equity			
Foreign Currency Financial Liabilities			
Amounts Payable to Banks and Financial Institutions	14	937,712	3,127,136
Derivative Financial Instruments	5	1,041,597	-
Amounts Payable to Asian Clearing Union	15	90,032,085	65,044,407
IMF Related Liabilities	16	328,772,419	275,420,837
Other Foreign Payable	17	58,621,764	5,014,191
Total Foreign Currency Financial Liabilities		479,405,577	348,606,571
Local Currency Financial Liabilities			
Deposits by Banks and Financial Institutions	18	146,269,185	104,853,445
Balances with Government and Governmental Entities	19	1,799,030	3,088,659
Securities Sold Under Agreement to Repurchase	20	14,089,000	113,454,891
Balances with Employee Benefit Plans	21	904,478	977,154
Other Payables	22	28,041,215	27,779,723
Total Local Currency Financial Liabilities		191,102,908	250,153,872
Total Financial Liabilities		670,508,485	598,760,443
Other Liabilities			
Currency in Circulation	23	293,233,361	255,652,217
Deferred Grants	24	3,468	4,605
Miscellaneous Liabilities and Accruals	25	884,048	74,381
Total Other Liabilities		294,120,877	255,731,203
Total Liabilities		964,629,362	854,491,646
Equity			
Capital Funds		25,000,000	25,000,000
Reserves		133,729,792	97,221,689
Total Equity		158,729,792	122,221,689
Total Liabilities and Equity		1,123,359,154	976,713,335

The Governor and the Chief Accountant of the Central Bank of Sri Lanka authorised these financial statements for issue on, 24th February 2012, for and on behalf of the Monetary Board.



Ajith Nivard Cabraal - Governor



M.I. Sufiyan - Chief Accountant

The accounting policies and notes on pages 07 through 44 form an integral part of the Financial Statements.

Central Bank of Sri Lanka
Income Statement
Year Ended 31 December 2011

	Note	2011 Rs. 000	2010 Rs. 000
Operating Income :			
Income from Foreign Currency Financial Assets			
Interest Income	28	14,435,116	10,841,880
Gain/(Loss) from Unrealized Price Revaluations		4,884,031	(3,484,968)
Gain from Realized Price Changes		33,113,886	27,643,286
Total Income from Foreign Currency Financial Assets		52,433,033	35,000,198
Expenses on Foreign Currency Financial Liabilities			
Interest Expense	29	(3,910,831)	(3,881,159)
Total Expenses on Foreign Currency Financial Liabilities		(3,910,831)	(3,881,159)
Net Foreign Exchange Revaluation Gain /(Loss)		3,576,999	(8,659,222)
Foreign Currency Investment Income		52,099,201	22,459,817
Income from Local Currency Financial Assets			
Interest Income	28	4,768,769	5,904,437
Interest Expense	29	(4,541,973)	(10,123,663)
Total Income from Local Currency Financial Assets		226,796	(4,219,226)
Other Income	30	669,399	825,681
Total Net Operating Income		52,995,396	19,066,272
Operating Expenses:			
Personnel Expenses:	31		
- Salaries and Wages		(2,274,045)	(2,224,931)
- Defined Contribution Plan Costs		(334,593)	(305,487)
- Additional Contribution to Post Employment Benefit Plan Costs		358,609	262,190
		<u>(2,250,029)</u>	<u>(2,268,228)</u>
Depreciation & Amortization		(314,063)	(278,453)
Cost of Inventory		(1,707,443)	(1,621,189)
Administration Expenses	32	(1,227,710)	(1,155,182)
Bad & Doubtful Debts and Net Sundry Write Offs		(64,352)	(1,108,000)
Total Operating Expenses		(5,563,597)	(6,431,052)
Profit Before Income Tax		47,431,799	12,635,220
Income Tax	33	(601,593)	(891,267)
Net Profit for the Year		46,830,206	11,743,953

The accounting policies and notes on pages 07 through 44 form an integral part of the Financial Statements.

Central Bank of Sri Lanka
Statement of Comprehensive Income
Year ended 31 December 2011

	2011 Rs. 000	2010 Rs. 000
Net Profit for the Year	46,830,206	11,743,953
Other Comprehensive Income		
Net Fair Value Loss on Available for Sale Securities	11,677,923	(5,889,977)
Total Comprehensive Income	<u>58,508,129</u>	<u>5,853,976</u>

The accounting policies and notes on pages 07 through 44 form an integral part of the Financial Statements.

Central Bank of Sri Lanka
Statement of Changes In Equity
Year ended 31 December 2011

	Reserves		Other		Retained	Total
	Contributed Capital Rs.000	Appropriated as Capital Rs.000	Revaluation Reserve Rs.000	Reserves (Note 26) Rs.000	Earnings Rs.000	Rs.000
As at 1 January 2010	15,000	24,985,000	2,706,067	77,462,952	26,530,787	131,699,806
Net Profit	-	-	-	-	11,743,953	11,743,953
Transfer to RTGS Sinking Fund	-	-	-	107,559	(107,559)	-
Transfer to General Reserve	-	-	-	700,975	(700,975)	-
Transfer to Market Valuation Reserve	-	-	-	(4,177,107)	4,177,107	-
Transfer of Net Foreign Exchange Revaluation Gain	-	-	-	(8,659,222)	8,659,222	-
Transfer to CBSL Specific Reserve	-	-	-	206,998	(206,998)	-
Other Comprehensive Income	-	-	-	(5,889,977)	-	(5,889,977)
Transfer of funds to CBSL Employees & Pension Disaster relief fund	-	-	-	-	(439)	(439)
Transfer of balance Profit to Government – 2009	-	-	-	-	(5,000,000)	(5,000,000)
Transfer of Profit in advance to Government – 2010	-	-	-	-	(10,000,000)	(10,000,000)
Transfer of Funds invested under voluntary deposit insurance Scheme to Sri Lanka Deposit Insurance Scheme	-	-	-	(331,653)	-	(331,653)
Transfer Funds to Provincial Credit Scheme	-	-	-	2,900,000	(2,900,000)	-
As at 1 January 2011	<u>15,000</u>	<u>24,985,000</u>	<u>2,706,067</u>	<u>62,320,525</u>	<u>32,195,098</u>	<u>122,221,689</u>
Net Profit	-	-	-	-	46,830,206	46,830,206
Transfer to RTGS Sinking Fund	-	-	-	113,381	(113,381)	-
Transfer to General Reserve	-	-	-	6,573,559	(6,573,559)	-
Transfer to Market Valuation Reserve	-	-	-	(3,484,968)	3,484,968	-
Transfer of Net Foreign Exchange Revaluation Gain	-	-	-	3,576,999	(3,576,999)	-
Transfer to CBSL Specific Reserve	-	-	-	113,561	(113,561)	-
Transfer to Medium & Long Term Reserve	-	-	-	2,000,000	(2,000,000)	-
Other Comprehensive Income	-	-	-	11,677,923	-	11,677,923
Transfer of funds to CBSL Employees & Pension Disaster relief fund	-	-	-	-	(27)	(27)
Transfer of balance Profit to Government – 2010	-	-	-	-	(5,000,000)	(5,000,000)
Transfer of Profit in advance to Government – 2011	-	-	-	-	(17,000,000)	(17,000,000)
As at 31 December 2011	<u>15,000</u>	<u>24,985,000</u>	<u>2,706,067</u>	<u>82,890,980</u>	<u>48,132,745</u>	<u>158,729,792</u>

The accounting policies and notes on pages 07 through 44 form an integral part of the Financial Statements.

Central Bank of Sri Lanka
Statement of Cash Flows
Year ended 31 December 2011

	Note	2011 Rs. 000	2010 Rs. 000
Cash Flow from Operating Activities			
Source:			
Interest Received - Foreign Currency		15,845,624	8,444,272
Interest Received - Local Currency - Others		473,847	401,620
Liquidity Management and Trading Income		33,113,886	27,643,286
Realised Exchange Gain / (Loss)		(10,121,791)	(2,150,718)
Other Income Received		668,262	657,674
		<u>39,979,828</u>	<u>34,996,134</u>
Disbursements:			
Interest Paid - Foreign Currency		3,885,126	3,695,818
Interest Paid - Local Currency		4,404,445	10,481,347
Payments to Employees		2,350,760	2,818,927
Payments to Suppliers		1,940,048	4,954,522
Income Tax Paid		607,900	884,633
		<u>13,188,279</u>	<u>22,835,247</u>
Net Cash Flow from Operating Activities	34	<u>26,791,549</u>	<u>12,160,887</u>
Cash Flows from Investing Activities			
Source:			
Net (Increase) /Decrease in Other Local Currency Financial Assets		(757,436)	(81,150)
Principal Recoveries from the Loans and Advances to Other Institutions		745,632	791,118
Disposal /Redemption of Investments in Financial and Other Institutions		24	2,619
Sale of Property, Plant and Equipment		124	4,332
Income on Investments in Financial and Other Institutions		4,124	11,695
Net Increase / (Decrease) in Securities Purchased under Agreement to Re-sell		(99,365,891)	29,432,245
		<u>(99,373,423)</u>	<u>30,160,859</u>
Disbursements:			
Net Increase / (Decrease) in Foreign Currency Securities		(181,397,956)	183,338,571
Net Increase / (Decrease) in Other Foreign Currency Financial Assets		190,664	(1,800,539)
Net Increase / (Decrease) in Other Foreign Currency Financial Liabilities		(87,450,517)	(26,948,525)
Net Increase / (Decrease) in Other Local Deposits and Payables		1,312	(2,861)
Purchase of Property, Plant and Equipment net of Grants		961,494	280,027
Net Increase / (Decrease) in Gold Inventory		8,663,832	(29,680,126)
Loans and Advances granted to other Institutions		599,318	1,954,823
Transfer of Deposit Insurance Fund Assets		-	331,653
		<u>(258,431,853)</u>	<u>127,473,023</u>
Net Cash Flow from Investing Activities		<u>159,058,430</u>	<u>(97,312,164)</u>
Cash Flow from Financing Activities			
Source:			
Issue of Circulating Currency		(335,393,178)	(260,277,179)
Withdrawal of Circulating Currency		372,974,278	298,499,562
Net Issue of Circulating Currency		<u>37,581,100</u>	<u>38,222,383</u>
Less:			
Net Withdrawals of Circulation Currency on Government Transactions	35	177,259,097	(25,210,557)
Net Withdrawals of Circulation Currency on Transactions with Banks and Financial Institutions	36	(41,477,740)	(18,866,241)
Net Withdrawals of Circulating Currency		<u>135,781,357</u>	<u>(44,076,798)</u>
Net Increase in Circulating Currency		<u>(98,200,257)</u>	<u>82,299,181</u>
Disbursements:			
Repayment of Foreign Currency Term Liabilities		(46,114,023)	(67,310,167)
Payments to Other Funds		27	439
Payments of Surplus to Government		22,000,000	15,000,000
		<u>(24,113,996)</u>	<u>(52,309,728)</u>
Net Cash Flow from Financing Activities		<u>(74,086,261)</u>	<u>134,608,909</u>
Net Increase in Cash and Cash Equivalents		111,763,718	49,457,632
Exchange Rate Effect on Cash and Cash Equivalents		2,109,928	(7,664,063)
Cash and Cash Equivalent at the Beginning of the Year		189,664,726	147,871,157
Cash and Cash Equivalent at 31 December	37	<u>303,538,372</u>	<u>189,664,726</u>

The accounting policies and notes on pages 07 through 44 form an integral part of the Financial Statements.

Central Bank of Sri Lanka

Notes to the Financial Statements

Year ended 31 December 2011

1. Reporting Entity And Statutory Base

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

These financial statements were authorised for issue by the Governor and Chief Accountant for and on behalf of the Monetary Board on 24 February 2012.

2. Accounting Policies

2.1 Basis of preparation

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

Reporting Format

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

Statement of Compliance

These financial statements of the Central Bank of Sri Lanka for the period ended 31 December 2011 have been prepared in accordance with International Financial Reporting Standards (IFRS). The financial statements prepared in accordance with the Monetary Law Act (MLA) are audited by the Auditor General and gazetted as required by the law. Due to certain requirements in the IFRS, the classifications, and hence the amounts in the gazetted financial statements would be different from those in these financial statements.

Currency of Presentation

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

2.2 Significant Accounting Judgments and Estimates

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

Impairment of Available for Sale Investments

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

Pensions and Other Post Employment Benefit Plans

The cost of defined benefit plans is determined using an actuarial valuation. The actuarial valuation involves making assumptions about discount rates, expected rates of return on assets, future compensation increases, mortality rates and future pension increases. Due to the long-term nature of these plans, such estimates are subject to significant uncertainty. Assumptions used are disclosed in Note 40.

2.3 Changes in Accounting Policy and Disclosures

The accounting policies adopted are consistent with those of the previous financial year, except for the following new and amended IFRS interpretations effective as of 1 January 2011:

IAS 24 Related Party Transactions (Amendment)

The IASB issued an amendment to IAS 24 that clarifies the definitions of a related party. The new definitions emphasise a symmetrical view of related party relationships and clarifies the circumstances in which persons and key management personnel affect related party relationships of an entity. In addition, the amendment introduces an exemption from the general related party disclosure requirements for transactions with government and entities that are controlled, jointly controlled or significantly influenced by the same government as the reporting entity. Bank has adopted this amendment to the Financial Statement disclosure.

Improvements to IFRSs

In May 2010, the IASB issued its third omnibus of amendments to its standards, primarily with a view to removing inconsistencies and clarifying wording. There are separate transitional provisions for each standard. The adoption of the following amendments resulted in changes to accounting policies, but no impact on the financial position or performance of the Bank.

- IFRS 7 Financial Instruments — Disclosures: The amendment was intended to simplify the disclosures provided by reducing the volume of disclosures around collateral held and improving disclosures by requiring qualitative information to put the quantitative information in context.
- IAS 1 Presentation of Financial Statements: The amendment clarifies that an entity may present an analysis of each component of other comprehensive income may be either in the statement of changes in equity or in the notes to the financial statements.

Other amendments resulting from Improvements to IFRSs to the following standards did not have any impact on the accounting policies, financial position or performance of the Bank:

- IFRS 3 Business Combinations (Contingent consideration arising from business combination prior to adoption of IFRS 3 (as revised in 2008))
- IFRS 3 Business Combinations (Un-replaced and voluntarily replaced share-based payment awards)
- IAS 27 Consolidated and Separate Financial Statements
- IAS 34 Interim Financial Statements

The following interpretation and amendments to interpretations did not have any impact on the accounting policies, financial position or performance of the Bank:

- IFRIC 13 Customer Loyalty Programmes (determining the fair value of award credits)
- IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments

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

Standards issued but not yet effective up to the date of issuance of the Bank's financial statements are listed below. This listing of standards and interpretations issued are those that the Bank reasonably expects to have an impact on disclosures, financial position or performance when applied at a future date. The Bank intends to adopt these standards when they become effective.

IAS 1 Financial Statement Presentation – Presentation of Items of Other Comprehensive Income (OCI)

The amendments to IAS 1 change the grouping of items presented in OCI. Items that could be reclassified (or 'recycled') to profit or loss at a future point in time (for example, upon derecognition or settlement) would be presented separately from items that will never be reclassified. The amendment affects presentation only and has there no impact on the Bank's financial position or performance. The amendment becomes effective for annual periods beginning on or after 1 July 2012.

IAS 19 Employee Benefits (Amendment)

The IASB has issued numerous amendments to IAS 19. These range from fundamental changes such as removing the corridor mechanism and the concept of expected returns on plan assets to simple clarifications and re-wording. The Bank is currently assessing the full impact of the remaining amendments. The amendment becomes effective for annual periods beginning on or after 1 January 2013.

IFRS 7 Financial Instruments: Disclosures — Enhanced Derecognition Disclosure Requirements

The amendment requires additional disclosure about financial assets that have been transferred but not derecognised to enable the user of the Bank's financial statements to understand the relationship with those assets that have not been derecognised and their associated liabilities. In addition, the amendment requires disclosures about continuing involvement in derecognised assets to enable the user to evaluate the nature of, and risks associated with, the entity's continuing involvement in those derecognised assets. The amendment becomes effective

for annual periods beginning on or after 1 July 2011. The amendment affects disclosure only and has no impact on the Bank's financial position or performance.

IFRS 9 Financial instrument: Classification and Measurement - IFRS 9 as issued reflects the first phase of the IASBs work on the replacement of IAS 39 and applies to classification and measurement of financial assets and liabilities as defined in IAS 39. The standard is effective for annual periods beginning on or after 01 January 2015. In subsequent phases, the board will address impairment and hedge accounting. The completion of this project is still in progress. The adoption of the first phase of IFRS 9 will primarily have an effect on the classification and measurement of the bank's financial assets. The bank is currently assessing the impact of adopting IFRS 9, however, the impact of adoption depends on the assets held by the bank at the date of adoption and it is not practical to quantify the effect.

IFRS 13 Fair Value Measurement

IFRS 13 establishes a single source of guidance under IFRS for all fair value measurements. IFRS 13 does not change when an entity is required to use fair value, but rather provides guidance on how to measure fair value under IFRS when fair value is required or permitted. The Bank is currently assessing the impact that this standard will have on the financial position and performance. This standard becomes effective for annual periods beginning on or after 1 January 2013.

3. Summary Of Significant Accounting Policies

3.1 Foreign Currency Conversions

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

Currency	2011 Rs.	2010 Rs.
1 Australian Dollar	115.5813	112.8836
1 Canadian Dollar	111.5750	110.9031
1 Euro	147.4225	147.5619
1 Japanese Yen	1.4669	1.3611
1 Special Drawing Rights (SDR)	174.4479	170.837
1 Sterling Pound	175.4479	171.4113
1 United States Dollar	113.9013	110.953
1 Chinese Yuan (Offshore)	17.9457	-

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

3.2 Financial Assets and Liabilities

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

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

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

Securities at Fair Value through Profit or Loss

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

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

Foreign Currency Available-for-Sale Investments

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

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

Derivative Instruments

The bank uses derivatives such as cross currency swaps and forward foreign exchange contracts. Derivatives are recorded at fair value and carried as assets when their fair value is positive and as liabilities when their fair value is negative. Changes in the fair value of derivatives are included in 'Gain / (Loss) from Unrealised Price Revaluations'.

International Monetary Fund (IMF) Related Balances

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

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

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

Cash and Cash Equivalents

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

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

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

CBSL through the cash/pay order process disburses cash in the form of Notes and Coins or cheques drawn on CBSL, to various drawees including suppliers and employees for goods and services obtained, which is either added to the

currency in circulation liability or Deposits by Banks and Financial Institutions. Such forms of utilization of currency for the purposes of CBSL's payments form part of cash outflows of CBSL.

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

Repurchase and Reverse-Repurchase Transactions

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

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

CBSL Securities

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

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

Investment Portfolio – Sri Lanka Government Securities

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

Advances to Government

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

Loans to Other Institutions

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

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 is used as the discount rate and it varies with the period of the loans.

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

Assumptions used for computation of fair valuation

- The staff loans granted from 2008 are considered.
- The date of staff loan granted is considered as 1 January.
- There were no amendments or early settlements.
- Capital and interest portion of housing loan instalments remains constant evenly throughout the period

Securities Borrowings and Securities Lending

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

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

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

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

Impairment of Financial Assets

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

Assets carried at Amortised Cost

If there is objective evidence that an impairment loss on loans and receivables carried at amortized cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the

present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition). The carrying amount of the asset shall be reduced either directly or through use of an allowance account. The amount of the loss shall be recognized in the Income Statement.

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

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

Available-for-Sale Investments

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

Foreign Currency Term Liabilities

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

Financial Guarantees

Financial Guarantees are initially recognised in the financial statements at fair value. Subsequent to initial recognition,

the bank's liability under each guarantee is measured at the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee.

Other Financial Assets and Liabilities

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

3.3 Other Assets and Liabilities

Gold

Section 67(1) of the Monetary Law Act which specifies the composition of the International Reserve indicates that gold may be held by the CBSL as part of this Reserve. Hence, CBSL holds Rs 56.9 Bn in allocated and unallocated gold as part of its International Reserves as at 31 December 2011. Generally, allocated gold is not considered as a financial asset whilst un-allocated gold is treated as a financial asset. Accordingly, allocated gold is recorded under Foreign Currency Non-Financial Assets and un-allocated gold is recorded under Foreign Currency Financial Assets. However, 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.

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.

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

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

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 realizable value after making due allowance for doubtful debts, based on objective evidence.

Sundry Assets

Other sundry assets are carried at expected realisable values.

Impairment of Non-Financial Assets

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

Provisions

Provisions are recognised when the bank has a present obligation (legal or constructive) as a result of a past event and it is probable that an outflow of resources embodying

economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where the bank expects a provision to be reimbursed, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain.

Currency in Circulation

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

Pension and Other Post Employee Benefit Plans

Pension and other Post Employment Benefit Plans operated by the bank are disclosed in Note 40.

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

Grants

Grants recognised at their fair value (where there is a reasonable assurance that the grant will be received and all attaching conditions, if any, will be complied with) are shown under equity. When the grant relates to an expense item it is recognised in the Income Statement over the periods necessary to match them to the expenses it is

intended to compensate on a systematic basis. Where the grant relates to an asset, the fair value is credited to a deferred government grant account and is released to the Income Statement over the expected useful life of the relevant asset on a systematic basis consistent with the depreciation policy of the related asset.

Personnel Expenses

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

Operating Leases

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

Income Tax

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

Revenue & Expenses

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

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

Interest

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

Dividends

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

Miscellaneous

Miscellaneous income and expenses are recognised on an accrual basis.

Net gains and losses of a revenue nature on the disposal of Property, Plant & Equipment have been accounted for in the Income Statement, having deducted from proceeds

on disposal, the carrying amount of the assets and related selling expenses.

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

Contingent Liabilities and Commitments including Off Statement of Financial Position Items

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

4. NATURE AND EXTENT OF ACTIVITIES

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

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

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

Foreign Currency Activities

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

exchange intervention purposes and other foreign currency assets held for trading purposes.

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

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

Local Currency Activities

Local currency activities arise as follows:

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

Trust and Custodial Activities

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

5. Derivative Financial Instruments

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

	Assets	Liabilities	Notional Amount	Assets	Liabilities	Notional Amount
	2011	2011	2011	2010	2010	2010
	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000
Currency SWAPS	2,794,334	1,041,597	310,813,574	-	-	-

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

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

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

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

Swaps

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

6. Financial Assets

	2011	2010
	Rs. 000	Rs. 000
Securities at Fair Value through Profit & Loss	92,856,165	183,729,813
Available for Sale Investments	270,664,801	346,935,603
Total Financial Assets	363,520,966	530,665,416

7. IMF Related Assets

	2011	2010
	Rs. 000	Rs. 000
Holding in Special Drawing Rights	502,112	273,070
IMF Quota	72,290,845	70,624,016
Deposits with IMF	137,934	134,753
Pre Paid Commitment Fee	159,626	167,430
Total IMF Related Assets	73,090,517	71,199,269

Holding of Special Drawing Rights (SDR)

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

IMF Quota

The International Monetary Fund (IMF) is an international organization of 187 member countries. It was established to promote international monetary cooperation, exchange stability, and orderly exchange arrangements; to foster economic growth and high levels of employment; and to provide temporary financial assistance to countries to help ease balance of payments adjustment. Quotas (capital subscriptions) are the primary source of IMF resources. The IMF receives its resources from its member countries. Each country's subscription or quota is determined broadly on the basis of the economic size of the country, and taking into account quotas of similar countries. Upon joining the IMF, a country must pay 25 percent of its quota in widely accepted foreign currencies or SDRs, and the remaining 75 percent in its own currency.

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

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

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

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

IMF quota therefore represents an asset, and the Bank transacting with the IMF in its own right rather than as an agent for the GOSL, reflects IMF Quota as an asset in its financial statements. The amounts payable in respect of the IMF Quota is shown under the heading Quota Liability in Note 16.

PRGF-HIPC Trust Deposit

The PRGF – HIPC (Poverty Reduction Growth Facility for the Heavily Indebted Poor Countries) Trust Deposit was made under the agreement between the GOSL and the IMF on 21 April 2000 by transferring SDR 788,783 from Sri Lanka's deposit in the post SCA-2 (Special Contingent Account) administered account with the IMF. This account was created under the guidance of the IMF by transferring the balance held in SCA-2 against Sri Lanka when it was decided to wind up SCA-2 by the IMF. IMF requested the

countries that had balances in the Post SCA-2 account to consider providing the balances in that account to the PRGF/HIPC trust either as outright grant or as a means of providing a subsidy for PRGF/HIPC Loan. Accordingly GOSL agreed to transfer the funds from Post SCA –2 accounts to PRGF/HIPC trust account, not as an outright grant, but as an interest free deposit until 2018.

8. Advances To Government

	2011 Rs. 000	2010 Rs. 000
Revolving Credit	94,743,013	77,878,823
	<u>94,743,013</u>	<u>77,878,823</u>

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

9. Loans To Other Institutions

	2011 Rs. 000	2010 Rs. 000
Loans & advances to failed Finance Companies – Others	-	1,936,494
Receivable under Medium & Long Term Credit Scheme (MLTC)		
- Related Parties	41,644	43,781
- Others	668	728
Receivable under Susahana Tsunami Loan Scheme Phase I & II:		
- Related Parties	314,388	513,788
- Others	129,472	214,058
Receivable under Provincial Development Credit Loan Scheme - Related Parties	1,854,663	1,714,793
Interest Receivable	-	4,217,766
Less:		
Suspended Interest	-	(4,217,766)
Allowance for Doubtful Receivables	(27,302)	(1,963,796)
Net Receivable	<u>2,313,533</u>	<u>2,459,846</u>

Movement in Allowance for Doubtful Receivables is as follows:

	2011 Rs. 000	2010 Rs. 000
At the beginning of the year	1,963,796	2,131,342
Write Off of Doubtful Debts	(1,936,494)	(167,546)
At the end of 31 December	<u>27,302</u>	<u>1,963,796</u>

The aggregate amount of non-performing loans on which interest was not recognised amounted to Rs. Nil as at 31 December 2011 (2010 - Rs. 1,936.494 Mn).

Writing-off of Outstanding Loans granted to Failed Finance Companies by CBSL

The Monetary Board of the CBSL has granted approval on 31 March 2011 to write off the outstanding balances of the direct loans & advances granted to failed finance companies amounting to Rs. 1,936.494 Mn and interest receivable amounting to Rs. 4,217.766 Mn. Accordingly the related provision for doubtful receivable and suspended interest also reduced by equal amounts.

10. Investments In Financial And Other Institutions

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

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

Investee	Business	% Holding	
		2011	2010
Lanka Clear (Private) Limited	Automated Clearing	19.66	19.66
Fitch Ratings Lanka Limited	Credit Rating	10	10
Lanka Financial Services Bureau Limited	Automated Fund Transfers	7.5	7.5
Credit Information Bureau of Sri Lanka Limited	Provision of Credit Information	19.68	19.76

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

	2011 Rs. 000	2010 Rs. 000
Credit Information Bureau of Sri Lanka Limited	5,961	5,986
Lanka Clear (Private) Limited	29,500	29,500
Fitch Ratings Lanka Limited	3,500	3,500
Lanka Financial Services Bureau Limited	2,250	2,250
Total Investments in Financial and Other Institutions	<u>41,211</u>	<u>41,236</u>

11. Inventories

	2011 Rs. 000	2010 Rs. 000
Notes for Circulation	1,895,335	1,476,072
Coins for Circulation	427,137	513,981
Notes in Transit	51,564	668,170
Coins in Transit	98,963	144,914
	<u>2,472,999</u>	<u>2,803,137</u>
Less:		
Allowance for Slow Moving Items	(25,000)	(25,000)
	<u>2,447,999</u>	<u>2,778,137</u>
Stationery and Sundry Inventory	36,682	36,647
Total Inventories at Lower of Cost and Net Realisable Value	<u>2,484,681</u>	<u>2,814,784</u>

12. Property, Plant And Equipment									
Others									
	Land and Buildings	Plant & Plant Integrals	Furniture & Equipment	Vehicles	Computers	Reading Materials	Construction In progress	2011 Total	2010 Total
	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000
Cost									
As at 01 January	8,534,843	1,067,926	668,687	279,627	670,310	39,546	199,340	11,460,279	11,193,439
Additions	214,538	32,695	64,264	41,144	42,885	7,931	844,033	1,247,490	446,551
Reclassification	-	-	8	-	(8)	-	-	-	-
Disposals / Transfers	-	(114)	(1,137)	-	(50)	(4)	(291,629)	(292,934)	(179,711)
As at 31 December	<u>8,749,381</u>	<u>1,100,507</u>	<u>731,822</u>	<u>320,771</u>	<u>713,137</u>	<u>47,473</u>	<u>751,744</u>	<u>12,414,835</u>	<u>11,460,279</u>
Depreciation									
	Land and Buildings	Plant & Plant Integrals	Furniture & Equipment	Vehicles	Computers	Reading Materials	Construction In Progress	2011 Total	2010 Total
	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000
As at 01 January	377,126	426,560	477,474	195,820	611,372	27,587	-	2,115,939	1,850,492
Depreciation for the year	132,049	53,802	48,159	39,118	29,377	875	-	303,380	269,499
Disposals	-	(58)	(1,073)	-	(50)	-	-	(1,181)	(4,052)
As at 31 December	<u>509,175</u>	<u>480,304</u>	<u>524,560</u>	<u>234,938</u>	<u>640,699</u>	<u>28,462</u>	<u>-</u>	<u>2,418,138</u>	<u>2,115,939</u>
Net Book Value	<u>8,240,206</u>	<u>620,203</u>	<u>207,262</u>	<u>85,833</u>	<u>72,438</u>	<u>19,011</u>	<u>751,744</u>	<u>9,996,697</u>	<u>9,344,340</u>
The book values of land and buildings are recorded at fair value. The latest independent valuation was performed as at 31 December 2007 by P. B. Kalugalagedara (Chartered Valuer), which was recorded as at 31 December 2007.									
Composition of Land and Buildings is as follows:									
	Carrying Value 2011	Carrying Value 2010							
	Rs. 000	Rs. 000							
Freehold Land	2,943,278	2,939,202							
Buildings on Freehold Land	5,229,793	5,138,725							
Buildings on Leasehold Land	67,135	79,791							
	<u>8,240,206</u>	<u>8,157,718</u>							
The carrying amount of revalued land & building that would have been included in the financial statements had they been carried at cost less depreciation is Rs. 6,609.783 Mn (2010 Rs. 6,944.193 Mn).									
The cost of fully depreciated assets of the Bank as at 31 December 2011 amounts to Rs. 1,847.819 Mn.(2010-Rs.1,475.265 Mn) and Bank has purchased Property, Plant & Equipments and Intangible assets amounting to Rs. 961.507 Mn in 2011 by payment of cash. (2010 – Rs. 280.027 Mn) .									
13. Intangible Assets									
Computer Software:									
Cost:									
As at 1 January			2011	2010					
			Rs. 000	Rs. 000					
Additions									
As at 31 December									
			590,097	580,794					
			5,634	9,303					
			<u>595,731</u>	<u>590,097</u>					
Amortization and Impairment:									
As at 1 January			572,344	564,411					
Amortization Charge for the year			9,664	7,933					
As at 31 December			<u>582,008</u>	<u>572,344</u>					
Net Book Value:									
As at 1 January			17,753	16,383					
As at 31 December			<u>13,723</u>	<u>17,753</u>					
14. Amounts Payable To Banks And Financial Institutions									
			2011	2010					
			Rs. 000	Rs. 000					
Payable to Foreign Banks			387,250	2,598,637					
Payable to other Foreign Financial Institutions			550,462	528,499					
			<u>937,712</u>	<u>3,127,136</u>					

15. Amount Payable To The Asian Clearing Union

	2011 Rs. 000	2010 Rs. 000
Payable as at the end of the year	90,032,085	65,044,407
	<u>90,032,085</u>	<u>65,044,407</u>

The Asian Clearing Union (ACU) was established in 1974 under the auspices of the Economic and Social Commission for Asia and the Pacific as a mechanism for settlement of payments among participating countries' Central Banks. Sri Lanka is one of the participants. The other participants are Bangladesh, the Islamic Republic of Iran, Nepal, Pakistan, India, Bhutan and Myanmar. This is a clearing facility to settle, on a multilateral basis, payments for current international transactions among territories of participants. Net position as at end of each month is settled or received, after two-month credit period. Interest between 0.00 % and 0.20 % in USD (2010- 0.18% and 0.21%) & Interest between 0.06 % and 1.11 % in EUR (2010 - 0.28% and 0.44 %) is paid by net debtors to the facility and transferred to net creditors on daily balances outstanding between settlement dates. Above balance represents the amounts due to ACU at the respective Statement of Financial Position dates.

16. IMF Related Liabilities

	2011 Rs. 000	2010 Rs. 000
Interest Bearing Loans - Non Current	189,229,942	144,098,362
Interest Bearing Loans - Current	6,463,246	1,311,686
Allocation of Special Drawing Rights	69,153,731	67,559,235
Other Amounts Payable to IMF	40,510,385	38,802,123
Quota Liability	23,415,115	23,649,431
	<u>139,542,477</u>	<u>131,322,475</u>
Total IMF Related Liabilities	<u>328,772,419</u>	<u>275,420,837</u>

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

Poverty Reduction & Growth Facility (PRGF)

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

Extended Fund Facility (EFF)

EFF is an IMF financing facility that supports medium term

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

Stand By Arrangement (SBA)

The executive board of the IMF approved a 20-month stand by arrangement for Sri Lanka in an amount equivalent to SDR 1.65 Bn (USD 2.6 Bn) on 24 July 2009 as a balance of payment (BOP) support the facility approved by the IMF equals 400 percent of Sri Lanka's Quotas. On 24 July 2009 and on 06 November 2009 the first two tranches of the loan equivalent to SDR 413.4 Mn (USD 651 Mn) were received by Sri Lanka. On 28th June 2010 another two tranches of the loan equivalent to SDR 275.6 Mn (USD 408 Mn) were received by Sri Lanka as 3rd and 4th tranches of the loan. Subsequently, on 24th September 2010, and on 3rd February 2011 the fifth and sixth tranches of the loan equivalent of SDR 275.6 Mn (USD 429 Mn) too were received by Sri Lanka. On 04 April 2011 the seventh tranche of the loan equivalent of SDR 137.8 Mn (USD 218 Mn) was received by Sri Lanka.

The remaining amount will be disbursed subject to completion of the reviews on economic performance of the country.

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

The key objectives of the SBA are as follows,

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

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

	Effective interest rate %	Maturity	2011 Rs. 000	2010 Rs. 000		2011 Rs. 000	2010 Rs. 000
Current					17. Other Foreign Payables		
EFF			602,424	-			
PRGF 2	0.50		1,342,644	1,311,686	Other Foreign Liabilities	2,414,801	2,240,366
SBA			4,518,178	-	China Development Bank (CDB) Loan	2,847,532	2,773,825
			<u>6,463,246</u>	<u>1,311,686</u>	Amount due to CDB under Escrow Agreement	53,359,431	-
						<u>58,621,764</u>	<u>5,014,191</u>
Non-current					China Development Bank Loan (CDB)		
SBA		2016	188,257,408	141,248,032	CBSL entered into an Agreement with the China Development Bank (CDB) on 25th July 2009 to promote financial and economic co-operation between the two institutions. Under this agreement, CDB will make available a credit facility in an aggregate amount up to the commitment of USD 25 million and CBSL will apply the proceeds of the facility for the purpose of financial stability of the country enhancing liquidity of the market and promoting the development of agriculture, infrastructure in Sri Lanka.		
PRGF 2	0.50	2013	671,322	1,967,530	Interest is calculated using the 6 months USD LIBOR plus a margin of 4%.		
EFF	1.11	2013	301,212	882,800	CBSL has to repay the facility in full on the final maturity date, the date falling thirty-six months after utilization date 14 August 2009.		
			<u>189,229,942</u>	<u>144,098,362</u>	Amount due to CDB under Escrow Agreement		
					A Facility Agreement between China Development Bank Corporation (CDB) and Government of Sri Lanka was signed on 31 March 2011 for USD 500 Million. According to the Facility Agreement, as Escrow Agent, an Escrow Account has been opened in the Central Bank of Sri Lanka for the sole purpose of deposit of the Loans, which account shall be jointly operated by the lender and the borrower pursuant to this Agreement.		
Total Interest bearing Loans			<u>195,693,188</u>	<u>145,410,048</u>	The first tranche of Escrow Funds USD 326 mn received on 29 June 2011 and second tranche of USD 174 mn received on 28 October 2011.		
					The lender instructs the Escrow Agent to disburse the Escrowed Funds in to the account specified in the Disbursement Request by sending a Notice of Approval to the Escrow Account.		
					After receiving a Notice of Approval from the CDB, first disbursement has been made on 18 October 2011 amounting to USD 1.768 Mn.		
Allocation of Special Drawing Rights (SDR)							
The SDR is a reserve asset created by the IMF in order to meet a long-term global need to supplement existing reserve assets. SDRs are allocated to member countries in proportion to their IMF quotas. SDR allocations can only be made to countries that participate in the IMF's SDR Department (an accounting unit within the IMF). The IMF to supplement existing official reserve assets, such as gold holdings, foreign exchange, and reserve positions in the IMF, created SDRs. Under certain conditions, which are set in the Articles of Agreement signed on behalf of the Government of Sri Lanka by the Bank, the IMF may allocate SDRs to members in proportion to their IMF quotas. An allocation of SDRs by the IMF provides each member with a costless asset on which interest is neither earned nor paid. The Articles of Agreement also allow for cancellations of SDRs, but to date, this provision has not been used. Increases in Allocation of SDR represents increases in Holding of SDR as described in Note 7. Members of IMF shall be obligated to pay to the IMF an amount equal to its net cumulative allocation and any other amounts that may be due and payable because of its participation in the Special Drawing Rights Department at the point of termination or liquidation of IMF's SDR Department.							
Other Amounts Payable to IMF							
These represent amounts owed by the Bank to IMF on account of operational and administrative transactions.							
Quota Liability							
The amounts payable in respect of the IMF Quota as described in Note 7 is shown under the heading Quota Liability.							

18. 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.

	2011 Rs. 000	2010 Rs. 000
Deposits by Banks :		
- Related Parties	75,337,875	55,282,083
- Others	70,925,920	49,563,846
	<u>146,263,795</u>	<u>104,845,929</u>
Deposits by Financial Institutions		
- Related Parties	117	368
- Others	5,273	7,148
	<u>5,390</u>	<u>7,516</u>
Total Deposits by Banks and Other Financial Institutions	<u>146,269,185</u>	<u>104,853,445</u>

19. Balances With Government And Government Entities

	2011 Rs. 000	2010 Rs. 000
Government Deposits	342,906	2,252,713
Government Agencies and Funds	1,456,124	835,946
	<u>1,799,030</u>	<u>3,088,659</u>

20. Securities Sold Under Agreement To Repurchase

	2011 Rs. 000	2010 Rs. 000
Government Securities	14,089,000	18,400,000
CBSL Securities	-	95,054,891
	<u>14,089,000</u>	<u>113,454,891</u>

21. 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:

	2011 Rs. 000	2010 Rs. 000
Employee Provident Fund	4,396	1,190
Employee Retirement Pension Scheme	(481,216)	(479,902)
Widows' /Widowers' & Orphans' Pension Schemes	723,969	698,177
Payable in respect of Gratuity Scheme	10,007	15,761
Payable in respect of Medical Benefit Scheme	647,322	741,928
Total Other Deposits	<u>904,478</u>	<u>977,154</u>

22. Other Payables

Other Payables includes Rs.1,434.625 Mn (2010 -1,175.758 Mn) payable in respect of abandoned properties collected from the licensed banks & financial institutions under the Banking act directions no.05 of 2009- Identifying, Reporting, Transferring & Maintaining Abandoned Property of Licensed Commercial banks. In the event of any further claims on abandoned properties, bank is liable to pay deposits so collected with interest. Hence the total deposit collected with the interest calculated on weighted average T. Bill interest rate is recorded as a liability of the bank.

Other payables also includes Rs. 23,142 Mn (2010 - Rs.23,433 Mn) deposit maintained by another Central Bank in relation to the SWAP facility.

23. Currency In Circulation

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

Denomination	2011 Rs. 000	2010 Rs. 000
Coins:		
1 cent	3,631	3,631
2 cent	5,702	5,702
5 cent	23,245	23,245
10 cent	39,209	39,212
25 cent	121,267	121,120
50 cent	185,505	185,633
1 rupee	660,639	613,826
2 rupee	920,287	863,079
5 rupee	2,776,439	2,624,778
10 rupee	848,538	645,699
Commemorative coins	568,403	549,496
	<u>6,152,865</u>	<u>5,675,421</u>

Notes:		
1 rupee	4,981	4,981
2 rupee	26,698	26,699
5 rupee	37,201	37,206
10 rupee	1,821,370	1,856,521
20 rupee	3,012,681	2,603,008
50 rupee	3,688,011	3,568,411
100 rupee	14,317,220	13,333,012
200 rupee	165,719	210,389
500 rupee	21,390,779	19,683,291
1000 rupee	105,362,876	109,381,997
2000 rupee	105,717,340	99,271,281
5000 rupee	31,535,620	-
	<u>287,080,496</u>	<u>249,976,796</u>
Total Currency in Circulation	<u><u>293,233,361</u></u>	<u><u>255,652,217</u></u>
24. Deferred Grants		
	2011	2010
	Rs. 000	Rs. 000
As at 01 January	4,605	567
Grant Received	-	4,500
Amortization during the year	(1,137)	(462)
As at 31 December	<u><u>3,468</u></u>	<u><u>4,605</u></u>
Deferred revenue is amortized over the period that matches with the depreciation policy of such assets.		
25. Miscellaneous Liabilities And Accruals		
Miscellaneous Liabilities and Accruals includes Rs. 747.262 Mn (2010 – Nil) recovered from DST's A/C on 30.12.2011 being the rupee equivalent of the repayment of Sri Lanka Development Bond amounting to USD 6.561 Mn. The repayment made in USD on 30.12.2011 has been returned due to an error and the repayment made subsequently on 03.01.2012. Therefore the rupee equivalent recovered on 30.12.2011 from the DST's A/C stood as a liability of the bank as at 31.12.2011		
26. Equity		
Nature of Equity Items		
Capital Funds		
Contributed Capital - The capital account represents the capital of the Bank in accordance with section 6 of the Monetary Law Act.		
Reserves Appropriated as Capital		
This Reserve is made up by transferring Rs.24,985 Mn out of the General Reserves in 2008, as per the Monetary Board decision of MB/F/22/12/2008		
In addition to the Retained Earnings, reserves comprise the following;		
International Revaluation Reserve(IRR) – International Revaluation Reserve is a reserve established in accordance with section 41 of the Monetary Law Act which requires that any unrealised gain or loss arising from the revaluation of net assets and liabilities of CBSL in gold or foreign currency shall not be considered in computing the net profit of the bank, instead such profit or loss should be transferred to the International Reserve Revaluation.		
Market Revaluation Reserve (MRR) and other reserves - Market Revaluation Reserve (MRR) was set up as per the Monetary Board decision of 30 January 2003, to transfer the price valuation gains from marking to market the foreign assets, in order to meet any adverse effects of volatilities in the international markets leading to adverse movements in market prices of the foreign financial assets. The Monetary Board has decided to build up this reserve to a maximum of 10% of the gross foreign reserves of the CBSL.		
Other reserves include General reserve, Building Reserve and Credit Guarantee. General Reserve includes the amounts set a side from the retained earnings By the Monetary Board.		
CBSL Specific Reserves - CBSL Specific Reserves includes the income earned from the investment of funds of Medical Benefit Support Fund (Pensioners) and Gratuity Fund.		
Net Fair Value/(Loss) on Available for Sale Securities and Allocated Gold Accounts - For the year ended 31 December 2011,unrealized gains and losses on the revaluation of securities designated as available for sale & un-allocated gold accounts, have been transferred to this reserve.		
RTGS Sinking Fund - This fund is built up with the charges collected from the participants for use of the RTGS system. The fund is limited to investments in treasury bills and bonds.		
Pension Fund Reserve - This reserve is made up by transferring an additional Rs.3 Bn from 2007 profits to be used to meet any shortfalls in the pension fund given the vulnerability of the income generating capacity of the Bank, to external risks.		
Technical Advancement Reserve - This reserve is built up from 2007 profits specifically to be used for technical advancement requirements, modification or upgrading of the IT systems currently used by the CBSL i.e., GL, RTGS,TDRMS,or,SSS.		
Provincial Development Credit Scheme - During 2010 bank has commenced a refinance credit scheme for medium & long term development purposes for provinces by creating a fund from the profits, amounting to Rs.2.9 Bn. Such loans are granted through Bank of Ceylon & Peoples' Bank.		
The movements in the other reserves are as follows:		

	Medium and Long Term Credit Reserve Rs. 000	Market Valuation & Other Reserves Rs. 000	CBSL Specific Reserves Rs. 000	RTGS Sinking Fund Rs. 000	IRR Rs. 000	Net Fair Value/ (Loss) on Available for Sale Securities Rs.000	Pension Fund Reserves Rs.000	Technical Advancement Reserves Rs. 000	Provincial Development Credit Scheme Fund Rs. 000	Total Rs. 000
As at 1 January 2011	9,425,000	13,092,442	618,337	405,466	38,834,492	(6,955,212)	3,000,000	1,000,000	2,900,000	62,320,525
Transfer of RTGS Income to RTGS Fund	-	-	-	113,381	-	-	-	-	-	113,381
Transfer of CBSL MBS Fund	-	-	107,927	-	-	-	-	-	-	107,927
Transfer of CBSL Gratuity Fund	-	-	5,634	-	-	-	-	-	-	5,634
Transfer of Profits to General Reserve & Building Reserve	-	6,573,559	-	-	-	-	-	-	-	6,573,559
Transfer of Profits to Market Valuation Reserve	-	(3,484,968)	-	-	-	-	-	-	-	(3,484,968)
Transfer of Net Foreign Exchange Revaluation Gain/ Loss	-	-	-	-	3,576,999	-	-	-	-	3,576,999
Net Fair value Loss on Available for sale Securities & gold	-	-	-	-	-	11,677,923	-	-	-	11,677,923
Transfer to Medium & Long Term Credit Reserves	2,000,000	-	-	-	-	-	-	-	-	2,000,000
As at 31 December 2011	11,425,000	16,181,033	731,898	518,847	42,411,491	4,722,711	3,000,000	1,000,000	2,900,000	82,890,980

27. Transfer Of Net Profits

Under section 39 (c) of the Monetary Law Act No. 58 of 1949, as amended, the Bank's net profit, as determined in accordance with the Act, is paid to the government after making necessary appropriations to Reserves under section 38 of the Monetary Law Act. During the Period bank transferred Rs.5 Bn in respect of 2010 profit and Rs. 17 Bn in respect of 2011 profit to the Government.

28. Interest Income From Financial Assets

	2011 Rs. 000	2010 Rs. 000
Interest Income from Foreign Currency Financial Assets		
Cash & Cash Equivalents	1,681,786	1,827,313
Financial Assets	12,733,199	9,001,207
IMF Related Assets	20,131	13,360
Total Interest Income from Foreign Currency Financial Assets	14,435,116	10,841,880
Interest Income from Local Currency Financial Assets		
Investment Portfolio – Sri Lanka Government Securities	4,280,118	5,517,540
Other Loans and Advances	488,651	386,897
Total Net Interest Income from Local Currency Financial Assets	4,768,769	5,904,437
Total Interest Income from Financial Assets	19,203,885	16,746,317

29. Interest Expense On Financial Liabilities

	2011 Rs. 000	2010 Rs. 000
Interest Expense on Foreign Currency Financial Liabilities		
Amount Payable to Asian Clearing Union	22,339	49,318
IMF Related Liabilities	3,123,782	1,700,366
Net SWAP Cost	620,598	1,971,544
Other Foreign Payable	144,112	159,931
Total Interest Expense on Foreign Currency Financial Liabilities	3,910,831	3,881,159
Interest Expense on Local Currency Financial Liabilities		
Securities Sold Under Agreements to Repurchase - Treasury Bills	1,592,397	2,069,217
- Treasury Bonds	2,645,210	1,369,727
Fees Paid on Bond Borrowing	105,483	58,736
CBSL Securities	42,073	6,625,983
Abandoned Property	156,810	-
Total Interest Expense on Local Currency Financial Liabilities	4,541,973	10,123,663
Total Interest Expense on Financial Liabilities	8,452,804	14,004,822

Bank has entered into a SWAP facility with a Foreign Central Bank from February 2009 for USD 200 Mn. A total sum of Rs 727.245 Mn (2010 – Rs.794.486 Mn) included in the Net SWAP Cost represent the cost incurred for SWAP facility with the Foreign Central Bank.

30. Other Income			(2010 – Rs. 5,517.540 Mn) & dividend income of Rs.12.534 Mn (2010 – Rs. 7.582 Mn). In addition, the Bank paid Economic Service Charge amounting to Rs. 120 Mn during the year of 2011 (2010 – Rs. 95.489 Mn).		
	2011 Rs. 000	2010 Rs. 000			
Dividend Income - Others	12,534	7,582			
Gain on Disposal of Property, Plant & Equipment	116	3,402			
Gain on Disposal of Investments in Financial and Other Institutions	541	39,304			
Amortization of Deferred Grant	1,137	462			
Miscellaneous Income	655,071	774,931			
Total Other Income	669,399	825,681			
31. Personnel Expenses			34. Reconciliation Of Operating Profit With Operating Cash Flow		
	2011 Rs. 000	2010 Rs. 000		2011 Rs. 000	2010 Rs. 000
Wages and Salaries including PAYE Tax paid by the Bank	2,274,045	2,224,931	Reported Net Profit from Operating Activities	46,830,206	11,743,953
Defined Contribution Plan Costs	334,593	305,487	Add / (Less) Non-Cash Items		
Post Employee Defined Benefit Plan Costs	(358,609)	(262,190)	Depreciation & Amortization	314,063	278,453
Total Personnel Expenses	2,250,029	2,268,228	Interest Received – Local Currency – Investment Portfolio	(4,280,118)	(5,517,540)
			Bad Debt Written Back	-	(167,545)
			Bad Debts & Other Sundry Written Off	64,352	1,108,000
			Gross Unrealised Foreign Exchange / (Gain) Loss	(13,698,790)	6,508,504
			Other Provision	246,201	323,525
			Deferred Grants	(1,137)	(462)
			Add/ (Less) Movements in Other Working Capital Items		
			(Increase) /Decrease in Inventories	330,103	(657,585)
			(Increase) /Decrease in Interest Receivable	1,391,580	(2,394,579)
			Increase / (Decrease) in Miscellaneous Liabilities	584,346	14,120
			Increase / (Decrease) in Interest Payable	6,422	(172,344)
			Increase / (Decrease) in Other Receivable	(115,773)	(2,402,277)
			Add / (Less) Investing and Financing Activities		
			Income from investment	4,125	11,695
			Net Unrealised Market Value Changes	(4,884,031)	3,484,968
			Net Cash Flow From Operating Activities	26,791,549	12,160,887
32. Administration Expenses			35. Issues/(Withdrawals) Of Circulation Currency On Government Transactions		
	2011 Rs. 000	2010 Rs. 000		2011 Rs. 000	2010 Rs. 000
Repairs and Maintenance	486,052	480,926	Purchases of Government of Sri Lanka Securities for Investment Portfolio	160,658,139	(21,279,060)
Information	81,904	90,284	Interest Received – Local Currency – Investment Portfolio	(1,550,509)	(7,191,222)
Operational Travel	85,006	63,071	Increase / (Decrease) in Advances to GOSL	16,864,190	3,998,323
Rental Expenses	2,460	919	(Increase) /Decrease in Balances with Government and Government Entities	1,287,277	(738,598)
Printing	30,589	23,703		177,259,097	(25,210,557)
Audit Fees - Current year	8,000	10,077			
- Previous year under provision	86	4,206			
Remuneration to Members of the Monetary Board	980	501			
Miscellaneous Expenses	532,633	481,495			
Total Other Operating Expenses	1,227,710	1,155,182			
<p>During the year, CBSL has paid Rs. 324.370 Mn which included in miscellaneous expenses as legal fees for foreign lawyers who appeared in the arbitration proceedings on hedging case initiated by Deutsche Bank AG against Democratic Socialist Republic of Sri Lanka.</p>			<p>33. Income Tax</p> <p>As per the Inland Revenue (Amendment) Act, No. 10 of 2007, dividend or interest will be liable to 10% withholding tax at the time of payment or crediting. The withholding tax on the interest income on the Government Securities is based on the weighted average yield rate of the closest primary auction adjusted to the days to maturity.</p> <p>During the period an amount of Rs. 481.593 Mn (2010 – Rs. 795.779 Mn) was expensed in relation to such withholding tax, payable on interest income of Rs. 4,280.118 Mn</p>		

36. Net Issues/(Withdrawals) Or Circulation Currency On Bank And Financial Institutions Transactions	2011	2010	37. Closing Cash And Cash Equivalents			
	Rs. 000	Rs. 000	2011		2010	
			Rs. 000	Rs. 000	Rs. 000	Rs. 000
(Increase) /Decrease in Deposits by Banks and Financial Institutions	(41,477,740)	(18,866,241)	Foreign Currency Assets			
	<u>(41,477,740)</u>	<u>(18,866,241)</u>	Cash Balances with Foreign Banks			
			303,538,372	189,664,726	303,538,372	189,664,726
			<u>303,538,372</u>	<u>189,664,726</u>	<u>303,538,372</u>	<u>189,664,726</u>
38. Concentrations Of Funding						
The Bank's significant end-of-year concentrations of funding were as follows.						
	Total	Sri Lanka Government	Sri Lanka Public	Sri Lanka Commercial Banks	Sri Lanka Supranational Financial Institutions	Other
As at 31 December, 2011	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000
Foreign Currency Financial Liabilities						
Amount Payable to Banks and Financial Institutions	937,712	-	-	-	411,840	525,872
Derivative Financial Instruments	1,041,597	-	-	212,575	12,096	816,926
Amount Payable to Asian Clearing Union	90,032,085	-	-	-	-	90,032,085
IMF Related Liabilities	328,772,419	-	-	-	328,772,419	-
Other Foreign Payables	58,621,764	-	-	1,995,232	414,478	56,212,054
Total Foreign Currency Financial Liabilities	479,405,577	-	-	2,207,807	329,610,833	147,586,937
Local Currency Financial Liabilities						
Deposits by Banks and Financial Institutions Balances with Government and Government Entities	146,269,185	-	-	146,263,795	-	5,390
Securities Sold Under Agreements to Repurchase	1,799,030	1,797,934	1,096	-	-	-
Balances with Employee Benefits Plan	14,089,000	-	-	13,850,000	-	239,000
Other Payables	904,478	-	-	-	-	904,478
	28,041,215	15,582	-	182,000	-	27,843,633
Total Local Currency Financial Liabilities	191,102,908	1,813,516	1,096	160,295,795	-	28,992,501
Total Financial Liabilities	670,508,485	1,813,516	1,096	162,503,602	329,610,833	176,579,438
Other Liabilities						
Currency in Circulation	293,233,361	-	293,233,361	-	-	-
Deferred Grants	3,468	-	-	-	-	3,468
Miscellaneous Liabilities and Accruals	884,048	25,031	-	-	-	859,017
Total Other Liabilities	294,120,877	25,031	293,233,361	-	-	862,485
Total Liabilities	964,629,362	1,838,547	293,234,457	162,503,602	329,610,833	177,441,923
Comparative Figures as at 31 December 2010 are as Follows;						
	Total	Sri Lanka Government	Sri Lanka Public	Sri Lanka Commercial Banks	Sri Lanka Supranational Financial Institutions	Others
As at 31 December 2010	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000
Foreign Currency Financial Liabilities						
Amount Payable to Banks and Financial Institutions	3,127,136	-	-	-	387,905	2,739,231
Amount Payable to Asian Clearing Union	65,044,407	-	-	-	65,044,407	-
IMF Related Liabilities	275,420,837	-	-	-	275,420,837	-
Other Foreign Payables	5,014,191	-	-	1,883,191	3,131,000	-
Total Foreign Currency Financial Liabilities	348,606,571	-	-	1,883,191	343,984,149	2,739,231

Local Currency Financial Liabilities							
Deposits by Banks and Financial Institutions	104,853,445	-	-	104,853,445	-	-	-
Balances with Government and Government Entities	3,088,659	2,252,713	835,946	-	-	-	-
Domestic Securities Issued by CBSL	95,054,891	-	-	95,054,891	-	-	-
Securities Sold Under Agreements to Repurchase	18,400,000	-	-	18,400,000	-	-	-
Balances with Employee Benefits Plan	977,154	-	-	-	-	-	977,154
Other Payables	27,779,723	8,148	1,175,758	182,000	-	-	26,413,816
Total Local Currency Financial Liabilities	250,153,872	2,260,861	2,011,704	218,490,336	-	-	27,390,970
Total Financial Liabilities	598,760,443	2,260,861	2,011,704	220,373,527	343,984,149	-	30,130,202
Other Liabilities							
Currency in Circulation	255,652,217	-	255,652,217	-	-	-	-
Deferred Grants	4,605	-	-	-	-	-	4,605
Miscellaneous Liabilities and Accruals	74,381	8,943	-	-	-	-	65,439
Total Other Liabilities	255,731,203	8,943	255,652,217	-	-	-	70,044
Total Liabilities	854,491,646	2,269,804	257,663,921	220,373,527	343,984,149	-	30,200,245

39. Risk Management

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

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

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

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

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

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

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

exchange rates is managed mainly through diversification of investment currencies. In the management of foreign reserves, minimizing liquidity risk is the prime consideration in order to maintain an effective foreign exchange intervention capability. Policies for managing the credit, interest rate, foreign exchange and liquidity risks are outlined in sections 39.1, 39.2, 39.3 & 39.4, respectively.

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

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

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

39.1 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.

	2011 Rs. 000	2010 Rs. 000
Concentrations of credit Exposure by geographical area		
Sri Lanka	288,634,753	107,853,799
USA	260,181,072	199,079,811
Japan	52,747,385	36,511,236
Britain	108,201,703	117,963,666
Europe	183,441,677	129,946,840
Supranational	122,497,146	138,080,144
Other	48,369,072	180,369,145
Total Financial Assets	1,064,072,808	909,804,641

(b) Concentrations of Credit Exposure

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

	2011 Rs. 000	2010 Rs. 000
Government	578,677,316	523,876,520
Supranational Financial Institutions	122,497,146	138,080,144
Foreign Banks and Financial Institutions	356,785,479	240,710,970
SL Banks & Financial Institutions	31,490	-
Other	6,081,377	7,137,007
Total Financial Assets	1,064,072,808	909,804,641

(c) Credit Exposure by Credit Rating

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

Credit Exposure by Credit Rating					
	Credit Rating	2011		2010	
		Rs. 000	%	Rs. 000	%
Cash & Cash Equivalents					
Federal Reserve Bank - USA/Reserve Bank of Australia/ Bank for International Settlements/ Bank of Japan					
	AAA	217,899,315	20.48%	54,443,540	5.98%
	AAA	2,267,476	0.21%	28,293,015	3.11%
	AA+	-	-	8,558,590	0.94%
	AA	-	-	39,473,242	4.34%
	AA-	75,192	0.01%	51,998,269	5.72%
	A+	5,324,713	0.50%	-	-
	A-	25,921	0.00%	-	-
	A	10,977	0.00%	-	-
	A-1+	-	-	5,870,267	0.65%
	A-1	-	-	617,323	0.07%
	NR	77,934,778	7.32%	410,480	0.05%
		<u>303,538,372</u>	<u>28.53%</u>	<u>189,664,726</u>	<u>20.85%</u>
Derivative Financial Instruments					
Federal Reserve Bank - USA/Reserve Bank of Australia/Bank for International Settlements/ Bank of Japan					
		136,504	0.01%	-	-
	AA-	837,196	0.08%	-	-
	A+	395,695	0.04%	-	-
	A	1,315,922	0.12%	-	-
	A-	40,134	0.00%	-	-
	NR	41,643	0.00%	-	-
Locally Rated	AA+	22,850	0.00%	-	-
	AA-	2,025	0.00%	-	-
	A	2,365	0.00%	-	-
		<u>2,794,334</u>	<u>0.26%</u>	<u>-</u>	<u>-</u>
Foreign Currency Trading/ Available for Sale Securities					
Federal Reserve Bank - USA/Reserve Bank of Australia/Bank for International Settlements/ Bank of Japan					
	AAA	243,614,704	22.89%	332,931,959	36.59%
	AA+	88,610,553	8.33%	2,759,132	0.30%
	AA	-	-	6,211,982	0.68%
	AA-	25,859,634	2.43%	10,075,211	1.11%
	A+	-	-	3,106,073	0.34%
	A-	-	-	8,243,605	0.91%
	CC	557,522	0.05%	-	-
	NR	4,878,554	0.46%	167,337,454	18.39%
		<u>363,520,967</u>	<u>34.16%</u>	<u>530,665,416</u>	<u>58.33%</u>
Trading Securities denominated in Gold	A+	13,150,196	1.24%	1,886,602	0.21%
		<u>13,150,196</u>	<u>1.24%</u>	<u>1,886,602</u>	<u>0.21%</u>
IMF Related Assets	AAA	73,090,516	6.87%	71,199,269	7.83%
		<u>73,090,516</u>	<u>6.87%</u>	<u>71,199,269</u>	<u>7.83%</u>
Other Foreign Receivables					
Federal Reserve Bank - USA/Reserve Bank of Australia/ Bank for International Settlements/ Bank of Japan					
		10,548	0.00%	8,450	0.00%
	AAA	17,528,808	1.65%	3,038,586	0.33%
	AA+	1,280,421	0.12%	257	0.00%
	AA	-	-	8,835	0.00%
	AA-	-	-	3,938	0.00%
	A	552,775	0.05%	-	-
	NR	2,609	0.00%	5,474,762	0.60%
		<u>19,375,161</u>	<u>1.82%</u>	<u>8,534,828</u>	<u>0.94%</u>
Total Foreign Currency Financial Assets		<u><u>775,469,546</u></u>	<u><u>72.88%</u></u>	<u><u>801,950,842</u></u>	<u><u>88.15%</u></u>

Local Currency Financial Assets																			
Sri Lanka Government Securities	B+	183,885,564	17.28%	20,497,816	1.93%														
Loans to Government	B+	94,743,013	8.90%	77,878,823	7.32%														
Loans to Other Institutions	NR	2,313,533	0.22%	2,459,846	0.23%														
Other Local Receivable	B+	2,399,849	0.23%	2,842,228	0.27%														
	NR	524,179	0.05%	432,664	0.04%														
Investments in Financial and Other Institutions	NR	41,211	0.00%	41,236	0.00%														
Other Assets	NR	3,202,868	0.30%	2,428,565	0.23%														
	B+	1,493,045	0.14%	1,272,621	0.12%														
Total Local Currency Financial Assets		288,603,262	27.12%	107,853,799	10.14%														
Total Financial Assets		1,064,072,808	100.00%	909,804,641	100.00%														
(d) Summary by Major Credit Category																			
Foreign Currency Financial Assets																			
Federal Reserve Bank - USA/Reserve Bank of Australia/Bank for International Settlements/ Bank of Japan		218,046,368	20.49%	54,451,990	5.99%														
IMF Related Assets		73,090,517	6.87%	71,199,269	7.83%														
	AAA	263,410,988	24.75%	364,263,560	40.04%														
	AA+/-	116,662,996	10.96%	119,089,455	13.09%														
	A+/-	20,816,333	1.96%	13,236,280	1.45%														
	A-1 +/-	-	-	6,487,590	0.71%														
	CC	557,522	0.05%	-	-														
	NR	82,857,582	7.79%	173,222,698	19.04%														
Locally Rated	AA+	22,850	0.00%	-	-														
	AA-	2,025	0.00%	-	-														
	A	2,365	0.00%	-	-														
Total Foreign Currency Financial Assets		775,469,546	72.88%	801,950,842	88.15%														
Local Currency Financial Assets																			
	B+/-	282,521,471	26.55%	100,114,231	11.00%														
	N/R	6,081,791	0.57%	7,739,568	0.85%														
Total Local Currency Financial Assets		288,603,262	27.12%	107,853,799	11.85%														
Total Financial Assets		1,064,072,808	100.00%	909,804,641	100.00%														
39.2 Interest Rate Risk																			
(a) Foreign Currency Interest rate sensitivity																			
Interest rate risk is the risk of loss arising from the changes in interest rates.																			
The interest rate sensitivity of the Fixed Income Securities portfolio measured by the potential loss incurred due to a rise in interest rate by 10 basis points is another risk measure used by the Bank Sensitivity of the risk exposure of the segmented Fixed Income Securities Portfolio is given below.																			
		<table border="1"> <thead> <tr> <th rowspan="2">Portfolio Segment</th> <th colspan="2">Potential Loss (USD Mn)</th> </tr> <tr> <th>2011</th> <th>2010</th> </tr> </thead> <tbody> <tr> <td>Trading</td> <td>5.52</td> <td>10.41</td> </tr> <tr> <td>Available for Sale</td> <td>9.94</td> <td>13.59</td> </tr> <tr> <td>Total</td> <td>15.46</td> <td>24.00</td> </tr> </tbody> </table>				Portfolio Segment	Potential Loss (USD Mn)		2011	2010	Trading	5.52	10.41	Available for Sale	9.94	13.59	Total	15.46	24.00
Portfolio Segment	Potential Loss (USD Mn)																		
	2011	2010																	
Trading	5.52	10.41																	
Available for Sale	9.94	13.59																	
Total	15.46	24.00																	
The Middle Office of IOD manages the interest rate risk of the foreign assets portfolio by employing the following strategies:																			
i) While the interest rate sensitivity measures the effect of a change in the interest rates on the foreign assets portfolio, CBSL uses Modified Duration (MD) as a measurement of interest rate risk which considers interest rates as well as the duration of an investment. The MD measures the change in price of a security for a given change in the interest rates (yield). A higher MD indicates a higher risk. Hence, the bank set an appropriate MD from time to time considering the developments in the financial markets, portfolio characteristics and the risk appetite of the Bank. As a general practice the upper limit for foreign exchange reserve holdings of Central Banks is specified around 2.5(overall), while it could vary downward depending on the market outlook and risk appetite of the Central Bank. By maintaining the MD within the upper limits set by the Bank, the interest rate risk and the duration risk of the foreign asset portfolio is managed. The MDs of the foreign assets portfolio, are tabulated below:																			

Modified Duration		
Investment Segment	Modified Duration	
	2011	2010
Money Market (Fixed and call deposits)	0.01	0.01
Capital Market (Fixed Income Securities)	4.66	4.96
Overall	2.70	3.72

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

Convexity of the segmented Fixed Income Securities portfolio

Portfolio Segment	Potential Loss (US\$ Mn)	
	2011	2010
Trading	0.45	0.51
Available for Sale	0.31	0.31
Total	0.35	0.38

iii). **Value at Risk**

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

Portfolio Segment	Value at Risk (VaR) US\$ mn
	2011
Trading	21.48
Available for Sale	34.39
Total	55.87

iv) **Trading & open position Limits**

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

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

The local Treasury bills portfolio is recorded in the Statement of Financial Position of the CBSL at amortized cost as it represents loans provided to the Government of Sri Lanka. This portfolio is not an investment portfolio, as the Bank does not purchase Treasury bills with the intention of earning an interest income. The bank purchases or sells Treasury bills to inject rupee liquidity into the domestic market or to absorb liquidity from the market in the course of carrying out its monetary policy operations in relation to one of its core objectives, namely maintaining economic and price stability. Hence, the volume of Treasury Bills in the Bank's portfolio is determined by its monetary policy operations. In addition, the basic interest rates in the rupee market, namely, the Repo rate and the Reverse Repo rate are policy rates determined by the Bank in the course of implementing its monetary policy. Moreover, the 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.

39.2 Interest Rate Risk (Continued)							
(C) Assets and liabilities will mature or re-price within the following Periods							
Foreign Currency Interest Rate Sensitivity Gap:	Weighted Ave. Int. Rate %	2011 Total Rs. 000	6 Months or Less Rs. 000	6 to 12 Months Rs. 000	1 to 2 Years Rs. 000	2 to 5 Years Rs. 000	Over 5 Years Rs. 000
Interest sensitive Foreign currency Financial Assets							
Cash & Cash equivalents	0.11	303,538,372	303,538,372	-	-	-	-
Securities at Fair Value through Profit and Loss and Available for Sale Investments	1.90	363,520,966	35,005,726	23,817,947	18,919,909	104,958,567	180,818,817
IMF related assets	0.11	8,870,519	8,870,519	-	-	-	-
Total Interest Sensitive Foreign Currency Financial Assets		675,929,857	347,414,617	23,817,947	18,919,909	104,958,567	180,818,817
Non Interest Sensitive Foreign Currency Financial Assets							
IMF Related assets		64,219,998	-	-	-	-	64,219,998
Derivative Financial Instruments		2,794,334	2,794,334	-	-	-	-
Receivables		19,375,161	19,375,161	-	-	-	-
Unallocated Gold		13,150,196	13,150,196	-	-	-	-
Total non Interest Sensitive Foreign Currency Financial Assets		99,539,689	35,319,691	-	-	-	64,219,998
Total Foreign Currency Financial Assets		775,469,546	382,734,308	23,817,947	18,919,909	104,958,567	245,038,815
Interest Sensitive Foreign Currency Financial Liabilities							
IMF related liabilities	0.01	195,693,187	972,534	5,490,711	52,178,549	137,051,393	-
Amounts payable to Asian Clearing Union	0.02	90,032,085	90,032,085	-	-	-	-
Total Interest Sensitive Foreign Currency Financial Liabilities		285,725,272	91,004,619	5,490,711	52,178,549	137,051,393	-
Non Interest Sensitive Foreign Currency Financial Liabilities							
Payables		937,712	937,712	-	-	-	-
Derivative Financial Instruments		1,041,597	1,041,597	-	-	-	-
IMF related liabilities		133,079,232	-	-	-	-	133,079,232
Commercial bank capital in foreign currency		1,995,232	-	-	-	-	1,995,232
Other foreign Liabilities		56,626,532	56,626,532	-	-	-	-
Total Non Interest Sensitive Foreign Currency Financial Liabilities		193,680,305	58,605,841	-	-	-	135,074,464
Total Foreign Currency Financial Liabilities		479,405,577	149,610,460	5,490,711	52,178,549	137,051,393	135,074,464
Foreign Currency Interest Rate Sensitivity Gap		390,204,585	256,409,998	18,327,236	(33,258,640)	(32,092,826)	180,818,817
	Weighted Ave. Int. Rate %	2011 Total Rs. 000	6 Months or Less Rs. 000	6 to 12 Months Rs. 000	1 to 2 Years Rs. 000	2 to 5 Years Rs. 000	Over 5 Years Rs. 000
Interest Sensitive Local Currency Financial Assets							
Investment portfolio-Sri Lanka							
Government Securities	7.56	164,421,565	143,326,695	21,094,870	-	-	-
Treasury Bills and Bond Reverse Repo	8.30	19,464,000	19,464,000	-	-	-	-
Loans to Other Institutions	7.01	2,313,532	331,456	481,804	938,048	562,224	-
Other assets - Staff Loans	3.77	3,202,868	73,252	74,397	152,314	486,686	2,416,219
- Others	8.19	1,493,045	72,094	-	124,017	1,296,934	-
Total Interest Sensitive Local Currency Financial Assets		190,895,010	163,267,497	21,651,071	1,214,379	2,345,844	2,416,219
Non Interest Sensitive Local Currency Assets							
Loans to Government		94,743,013	94,743,013	-	-	-	-
Receivables		2,924,028	2,923,630	-	-	-	398
Investment in Equity Securities - Available for Sale		41,211	-	-	-	-	41,211
Total non Interest Sensitive Local Currency Assets		97,708,252	97,666,643	-	-	-	41,609
Total Local Currency Assets		288,603,262	260,934,140	21,651,071	1,214,379	2,345,844	41,609
Interest Sensitive Local Currency Financial Liabilities							
Securities sold under agreement to repurchase	7.00	14,089,000	14,089,000	-	-	-	-
Total Interest Sensitive Local Currency Financial Liabilities		14,089,000	14,089,000	-	-	-	-

Non Interest Sensitive Local Currency Liabilities							
Balances with Banks and Financial Institutions		146,269,185	146,269,185	-	-	-	-
Balances with Government and Government Entities		1,799,030	1,799,030	-	-	-	-
Balances with Employee Benefit Plans		904,478	904,478	-	-	-	-
Other Payables		28,041,215	28,041,215	-	-	-	-
Total Non interest sensitive Local currency financial liabilities		177,013,908	177,013,908	-	-	-	-
Total Local currency financial liabilities		191,102,908	191,102,908	-	-	-	-
Local Currency Interest Rate Sensitivity Gap		176,806,010	149,178,497	21,651,071	1,214,379	2,345,844	2,416,219
Comparative figures as at 31 December 2010 were as follows							
Foreign Currency Interest Rate Sensitivity Gap:	Weighted Ave. Int. Rate %	2010 Total Rs. 000	6 Months or Less Rs. 000	6 to 12 Months Rs. 000	1 to 2 Years Rs. 000	2 to 5 Years Rs. 000	Over 5 Years Rs. 000
Interest Sensitive Foreign currency financial assets							
Cash & Cash equivalents	0.25	189,664,726	189,664,726	-	-	-	-
Securities at Fair Value through Profit and Loss and Available for Sale Investments	2.86	530,665,416	21,235,923	39,281,454	56,457,478	127,798,550	285,892,011
IMF related assets	0.32	273,070	273,070	-	-	-	-
Total Interest Sensitive Foreign Currency Financial Assets		720,603,212	211,173,720	39,281,454	56,457,478	127,798,550	285,892,011
Non Interest Sensitive Foreign Currency Financial Assets							
IMF Related assets		70,926,199	-	-	-	-	70,926,199
Receivables		8,534,829	8,534,828	-	-	-	-
Unallocated Gold		1,886,602	1,886,602	-	-	-	-
Total Non Interest Sensitive Foreign Currency Financial Assets		81,347,630	10,421,430	-	-	-	70,926,199
Total Foreign Currency Financial Assets		801,950,842	221,595,150	39,281,454	56,457,478	127,798,550	356,818,210
Interest Sensitive Foreign Currency Financial Liabilities							
IMF related liabilities	0.02	145,410,048	655,843	655,843	6,314,221	137,784,141	-
Amounts payable to Asian Clearing Union	0.21	65,044,407	65,044,407	-	-	-	-
Total Interest Sensitive Foreign Currency Financial Liabilities		210,454,455	65,700,250	655,843	6,314,221	137,784,141	-
Non Interest Sensitive Foreign Currency Financial Liabilities							
IMF related liabilities		130,384,184	373,395	-	-	-	130,010,789
Commercial bank capital in foreign currency		1,883,191	-	-	-	-	1,883,191
Other foreign liabilities		5,884,741	5,884,741	-	-	-	-
Total Non Interest Sensitive Foreign Currency Financial Liabilities		138,152,116	6,258,136	-	-	-	131,893,980
Total Foreign Currency Financial Liabilities		348,606,571	71,958,386	655,843	6,314,221	137,784,141	131,893,980
Foreign Currency Interest Rate Sensitivity Gap		510,148,758	145,473,470	38,625,610	50,143,257	(9,985,590)	285,892,011
Interest Sensitive Local Currency Financial Assets							
Investment Portfolio-Sri Lanka Government Securities	7.28	20,497,816	7,113,152	13,384,664	-	-	-
Loans to Other Institutions	6.49	2,459,846	280,955	168,590	255,725	1,754,576	-
Other Assets - Staff Loan	3.70	2,428,565	53,352	54,151	110,756	352,992	1,857,314
- Other	7.59	1,272,621	340,938	716,936	83,666	131,081	-
Total Interest Sensitive Local Currency Financial Assets		26,658,848	7,788,396	14,324,340	450,148	2,238,649	1,857,314

Non Interest Sensitive Local Currency Assets						
Loans to Government		77,878,823	77,878,823	-	-	-
Receivables		3,274,892	2,809,921	-	-	464,971
Investment in Equity Securities - Available for Sale		41,236	-	-	-	41,236
Total Non Interest Sensitive Local Currency Assets		81,194,951	80,688,744	-	-	506,207
Total Local Currency Assets		107,853,799	88,477,140	14,324,340	450,148	2,238,649
Interest Sensitive Local Currency Financial Liabilities						
Securities sold under agreement to repurchase	7.25	18,400,000	18,400,000	-	-	-
Domestic Securities Issued by CBSL	7.25	95,054,891	95,054,891	-	-	-
Total Interest Sensitive Local Currency Financial Liabilities		113,454,891	113,454,891	-	-	-
Non Interest Sensitive Local Currency Liabilities						
Balances with Banks and Financial Institutions		104,853,445	104,853,445	-	-	-
Balances with Government and Government Entities		3,088,658	3,088,658	-	-	-
Balances with Employee Benefit Plans		977,154	107,454	-	869,700	-
Other Payables		27,779,723	27,779,723	-	-	-
Total Non Interest Sensitive Local Currency Financial Liabilities		136,698,980	135,829,280	-	869,700	-
Total Local Currency Financial Liabilities		250,153,871	249,284,171	-	869,700	-
Local Currency Interest Rate Sensitivity Gap		(86,796,043)	(105,666,494)	14,324,340	450,148	2,238,649

39.3 Foreign Currency Risk

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

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

(b) Net Exposure to foreign currencies

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

	Currency							Total All Currencies
	United States Dollars	Euro	Japanese Yen	Sterling Pound	SDR	AUD	Other Currencies	
As at 31 December 2011	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000
Foreign Currency Financial Assets								
Cash & Cash Equivalents	(73,517,331)	81,376,905	36,671,484	142,982,620	-	66,723,350	49,301,344	303,538,372
Derivative Financial Instruments	73,132	-	-	290,393	-	2,430,809	-	2,794,334
Securities at Fair Value through Profit and Loss and Available for Sale Investments	118,675,872	57,067,777	16,560,479	103,296,118	-	56,614,482	11,306,238	363,520,966
Unallocated Gold	-	-	-	13,150,196	-	-	-	13,150,196
IMF Related Assets	-	-	-	-	73,090,517	-	-	73,090,517
Other Foreign Receivables	543,111	9,174,356	93	7,318,149	2,435	2,336,824	193	19,375,161
Total Foreign Currency Financial Assets	45,774,784	147,619,038	53,232,056	267,037,476	73,092,952	128,105,465	60,607,775	775,469,546
Proportion	6%	19%	7%	34%	9%	17%	8%	100%
Foreign Currency Financial Liabilities								
Amount Payable to Banks and Financial Institutions	138,621	-	-	-	411,840	387,251	-	937,712
Derivative Financial Instruments	212,575	-	-	374,384	-	454,638	-	1,041,597
Amount Payable to Asian Clearing Union	90,133,003	(100,918)	-	-	-	-	-	90,032,085
IMF Related Liabilities	-	-	-	-	328,772,419	-	-	328,772,419
Other foreign liabilities	58,621,764	-	-	-	-	-	-	58,621,764
Total Foreign Currency Financial Liabilities	149,105,963	(100,918)	-	374,384	329,184,259	841,889	-	479,405,577
Proportion	31%	0%	-	0	69%	0%	-	100%
Net Foreign Currency Exposure	(103,331,179)	147,719,956	53,232,056	266,663,092	(256,091,307)	127,263,576	60,607,775	296,063,969

39.3 Foreign Currency Risk (Continued)

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

	Currency							Total All Currencies Rs. 000
	United States Dollars Rs. 000	Euro Rs. 000	Japanese Yen Rs. 000	Sterling Pound Rs. 000	SDR Rs. 000	AUD Rs. 000	Other Currencies Rs. 000	
As at 31 December 2010								
Foreign Currency Financial Assets								
Cash & Cash Equivalents	110,943,443	18,181,304	27,168,738	31,237,633	-	1,283,105	850,504	189,664,726
Securities at Fair Value through Profit and Loss and Available for Sale Investments	227,595,072	84,105,234	8,223,203	116,674,396	-	92,352,204	1,715,307	530,665,416
Unallocated Gold	-	-	-	1,886,602	-	-	-	1,886,602
IMF Related Assets	-	-	-	-	71,199,269	-	-	71,199,269
Other Foreign Receivables	14,963	6,831,798	1,643,522	952	2,119	41,474	-	8,534,829
Total Foreign Currency Financial Assets	338,553,478	109,118,335	37,035,463	149,799,583	71,201,388	93,676,783	2,565,811	801,950,842
Proportion	42%	14%	5%	18%	9%	12%	0%	100%
Foreign Currency Financial Liabilities								
Amount Payable to Banks and Financial Institutions	153,115	1,504,401	1,094,297	340	373,395	1,588	-	3,127,136
Amount Payable to Asian Clearing Union	66,151,121	(1,106,714)	-	-	-	-	-	65,044,407
IMF Related Liabilities	-	-	-	-	275,420,837	-	-	275,420,837
Commercial Banks – Capital Deposits in Foreign Currency	5,014,191	-	-	-	-	-	-	5,014,191
Total Foreign Currency Financial Liabilities	71,318,427	397,687	1,094,297	340	275,794,232	1,588	-	348,606,570
Proportion	20%	0%	0%	0%	79%	0%	-	100%
Net Foreign Currency Exposure	267,235,051	108,720,649	35,941,166	149,799,243	(204,592,843)	93,675,195	2,565,811	453,344,272

39.4 Liquidity risk

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

(a) Liquidity is a key consideration in determining the composition of the Bank's foreign currency assets. This reflects the potential requirement to liquidate

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

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

Fair values and carrying amount

Fair values	Carrying Amount		Fair Value	
	2011 Rs '000	2010 Rs '000	2011 Rs '000	2010 Rs '000
Foreign Currency Financial Assets				
Cash & Cash Equivalents	303,538,372	189,664,726	303,538,372	189,664,726
Derivative Financial Instruments	2,794,334	-	2,794,334	-
Foreign Currency Trading/ Available for Sale Securities	363,520,966	530,665,416	363,520,966	530,665,416
IMF Related Assets	73,090,517	71,199,269	73,090,517	71,199,269
Unallocated Gold	13,150,196	1,886,602	13,150,196	1,886,602
Other Foreign Receivables	19,375,161	8,534,829	19,375,161	8,534,829
Total Foreign Currency Financial Assets	775,469,546	801,950,842	775,469,546	801,950,842

Local Currency Financial Assets				
Sri Lanka Government Securities	183,885,564	20,497,816	183,885,564	20,497,816
Loans to Government	94,743,013	77,878,823	94,743,013	77,878,823
Loans to Other Institutes	2,313,533	2,459,846	2,313,533	2,459,846
Other Local Receivables	2,924,028	3,274,892	2,924,028	3,274,892
Investment in Financial and Other Institutions	41,211	41,236	41,211	41,236
Other Assets	4,695,913	3,701,186	4,695,913	3,701,186
Total Local Currency Financial Assets	288,603,262	107,853,799	288,603,262	107,853,799
Total Financial Assets	1,064,072,808	909,804,641	1,064,072,808	909,804,641
Foreign Currency Non-Financial Assets				
Allocated Gold	43,819,156	52,120,605	43,819,156	52,120,605
Total Foreign Currency Non-Financial Assets	43,819,156	52,120,605	43,819,156	52,120,605
Foreign Currency Financial Liabilities				
Amounts payable to Banks & Financial Institution	937,712	3,127,136	937,712	3,127,136
Derivative Financial Instruments	1,041,597	-	1,041,597	-
IMF related Liabilities	328,772,419	275,420,837	328,772,419	275,420,837
Amounts payable to ACU	90,032,085	65,044,407	90,032,085	65,044,407
Other Foreign Payables	58,621,764	5,014,191	58,621,764	5,014,191
Total Foreign Currency Financial Liabilities	479,405,577	348,606,571	479,405,577	348,606,571
Local Currency Financial Liabilities				
Commercial Banks & Other Financial Institutions	146,269,185	104,853,445	146,269,185	104,853,445
Balances with Government and Government Entities	1,799,030	3,088,659	1,799,030	3,088,659
Securities Sold under Agreement to Repurchase	14,089,000	113,454,891	14,089,000	113,454,891
Balances with Employee Benefits Plan	904,478	977,154	904,478	977,154
Other Payables	28,041,215	27,779,723	28,041,215	27,779,723
Total Local Currency Financial Liabilities	191,102,908	250,153,872	191,102,908	250,153,872
Total Financial Liabilities	670,508,485	598,760,443	670,508,485	598,760,443

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

40. Pension And Other Post Employment Benefit Plans

The Bank operates five defined benefit plans which cover all eligible employees. Under the Employees' Retirement Pension Scheme, employees who joined the Bank prior to 1 January 1998 and complete 10 years of service become eligible. The Pension Scheme is a non-contributory pension scheme where the cost of benefits is wholly borne by the Bank. The Widows' and Orphans' Pension Scheme for male employees and Widowers' and Orphans' Pension Scheme for female employees are open to employees of the Bank who had joined prior to 1 January 1998.

Employees eligible under these plans contribute 5% of the monthly basic salary, who were recruited before 1 August 1994 & 10% of monthly basic salary who were recruited on or after 01 August 1994.

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

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

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

Orphans' Pension Scheme, Gratuity Scheme and Medical Benefit Scheme during the year.

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

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

The total fair value of plan assets of Rs.26,558.264 Mn (2010 – Rs.26,012.196 Mn) exceeds the total present value of all benefit obligations of Rs.25,537.339 Mn (2010 – Rs.23,795.334 Mn) at the end of the reporting period resulting in a surplus of Rs. 1,020.925 Mn (2010 – Rs.2,216.862 Mn).

2011

Benefit Liability/(Assets)	Employee Retirement Pension Scheme	Widows' and Orphans' Pension Scheme	Widowers' and Orphans' Pension Scheme	Gratuity Scheme	Medical Benefit Scheme	Total 2011
	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000
Present Value of Benefit Obligation	20,911,869	2,708,432	547,074	89,655	1,280,309	25,537,339
Fair Value of Plan Assets	(19,281,669)	(4,724,335)	(1,320,757)	(54,417)	(1,177,086)	(26,558,264)
Unrecognised net Actuarial Gains /(Losses)	(1,230,859)	1,070,435	420,301	(1,851)	(228,672)	29,354
Benefit Liability/ (Asset) non-current	399,341	(945,468)	(353,382)	33,387	(125,449)	(991,571)

Movement in the Benefit Liability /(Asset)	Employee Retirement Pension Scheme	Widows' and Orphans' Pension Scheme	Widowers' and Orphans' Pension Scheme	Gratuity Scheme	Medical Benefit Scheme	Total 2011
	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000
At 1 January 2011	483,248	(905,324)	(342,465)	19,025	(124,184)	(869,700)
Benefit Expense	240,264	(393,534)	(182,291)	14,362	(1,265)	(322,464)
Contribution Paid	(324,171)	353,390	171,374	-	-	200,593
At 31 December 2011 - non-current	399,341	(945,468)	(353,382)	33,387	(125,449)	(991,571)

Benefit Expense	Employee Retirement Pension Scheme	Widows' and Orphans' Pension Scheme	Widowers' and Orphans' Pension Scheme	Gratuity Scheme	Medical Benefit Scheme	Total 2011
	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000
Interest Cost on Benefit Obligation	1,953,600	266,551	50,057	6,178	103,147	2,379,533
Expected Return on Plan Assets	(1,850,152)	(479,339)	(144,437)	(5,133)	(122,160)	(2,601,221)
Net Actuarial (Gain) /Loss recognized during the year	-	(180,746)	(87,911)	(171)	-	(268,828)
Transitional Adjustment	-	-	-	-	-	-
Net Current Service Cost	136,816	-	-	13,488	17,748	168,052
Past Service Cost	-	-	-	-	-	-
Net Benefit Expense	240,264	(393,534)	(182,291)	14,362	(1,265)	(322,464)
Actual Return on Plan Assets	1,371,971	468,378	60,634	8,154	56,087	1,965,224

Changes in Fair Value of Plan Assets	Employee Retirement Pension Scheme	Widows' and Orphans' Pension Scheme	Widowers' and Orphans' Pension Scheme	Gratuity Scheme	Medical Benefit Scheme	Total 2011
	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000
Fair Value of Plan Assets at the beginning of the year	18,501,515	4,793,392	1,444,366	51,325	1,221,598	26,012,196
Actual Return on Plan Assets	1,371,971	468,378	60,634	8,154	56,087	1,965,224
Contribution Received	324,171	(353,390)	(171,374)	-	-	(200,593)
Benefits Paid	(915,988)	(184,045)	(12,869)	(5,062)	(100,599)	(1,218,563)
Fair value of Plan Assets at the end of the year	19,281,669	4,724,335	1,320,757	54,417	1,177,086	26,558,264
2010						
Benefit Liability/(Asset)	Employee Retirement Pension Scheme	Widows' and Orphans' Pension Scheme	Widowers' and Orphans' Pension Scheme	Gratuity Scheme	Medical Benefit Scheme	Total 2010
	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000
Present Value of Benefit Obligation	19,536,003	2,665,510	500,571	61,781	1,031,469	23,795,334
Fair Value of Plan Assets	(18,501,515)	(4,793,392)	(1,444,366)	(51,325)	(1,221,598)	(26,012,196)
Unrecognised net Actuarial Gains /(Losses)	(551,240)	1,222,558	601,330	8,569	65,945	1,347,162
Benefit Liability/ (Asset) non-current	483,248	(905,324)	(342,465)	19,025	(124,184)	(869,700)
Movement in the Benefit Liability/(Asset)	Employee Retirement Pension Scheme	Widows' and Orphans' Pension Scheme	Widowers' and Orphans' Pension Scheme	Gratuity Scheme	Medical Benefit Scheme	Total 2010
	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000
At 1 January 2010	482,363	(512,892)	(154,316)	6,618	(115,250)	(293,477)
Benefit Expense	324,168	(372,329)	(179,327)	12,407	(8,934)	(224,015)
Contribution Paid	(323,283)	(20,103)	(8,822)	-	-	(352,208)
At 31 December 2010 - non-current	483,248	(905,324)	(342,465)	19,025	(124,184)	(869,700)
Benefit Expense	Employee Retirement Pension Scheme	Widows' and Orphans' Pension Scheme	Widowers' and Orphans' Pension Scheme	Gratuity Scheme	Medical Benefit Scheme	Total 2010
	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000
Interest Cost on Benefit Obligation	1,851,102	252,315	47,391	4,851	92,814	2,248,473
Expected Return on Plan Assets	(1,658,096)	(427,438)	(127,246)	(4,567)	(115,810)	(2,333,157)
Net Actuarial (Gain) /Loss recognized during the year	-	(197,206)	(99,472)	-	(2,738)	(299,416)
Transitional Adjustment	-	-	-	-	-	-
Net Current Service Cost	131,162	-	-	12,123	16,800	160,085
Past Service Cost	-	-	-	-	-	-
Net Benefit Expense	324,168	(372,329)	(179,327)	12,407	(8,934)	(224,015)
Actual Return on Plan Assets	2,492,358	667,371	175,787	9,112	164,987	3,509,615
Changes in Fair Value of Plan Assets	Employee Retirement Pension Scheme	Widows' and Orphans' Pension Scheme	Widowers' and Orphans' Pension Scheme	Gratuity Scheme	Medical Benefit Scheme	Total 2010
	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000
Fair Value of Plan Assets at the beginning of the year	16,580,964	4,274,380	1,272,456	45,669	1,158,099	23,331,568
Actual Return on Plan Assets	2,492,358	667,371	175,787	9,112	164,987	3,509,615
Contribution Received	323,283	20,103	8,822	-	-	352,208
Benefits Paid	(895,090)	(168,462)	(12,699)	(3,456)	(101,488)	(1,181,195)
Fair value of Plan Assets at the end of the year	18,501,515	4,793,392	1,444,366	51,325	1,221,598	26,012,196

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

	2011	2010
Discount Rate	10.00%	10.00%
Expected Rate of Return on Assets	10.00%	10.00%
Future Salary Increases	8.50%	8.50%
Future Pension Increases	7.50%	7.50%
Average Remaining years of Service		
CBSL Pension	2 Years	2 Years
W & OP Pension scheme	4 Years	4 Years
WR & OP Pension scheme	5 Years	5 Years
Gratuity scheme	14 Years	14 Years
CBSL Medical Benefit scheme	8 Years	8 Years
Retirement Age	60 years	60 years

41. Financial Instruments

Fair Value of Financial Instruments

The fair value of financial instruments is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arms-length transaction. When a financial instrument is traded in an

31 December 2011	Level 1 Rs. 000	Level 2 Rs. 000	Level 3 Rs. 000	Total
Financial Assets				
Derivatives	-	2,794,334	-	2,794,334
Securities at Fair Value through Profit or Loss	92,856,165	-	-	92,856,165
Available for Sale Investments	270,664,801	-	-	270,664,801
Unallocated Gold	13,150,196	-	-	13,150,196
	<u>376,671,162</u>	<u>2,794,334</u>	<u>-</u>	<u>379,465,496</u>
Financial Liabilities				
Derivatives	-	1,041,597	-	1,041,597
	<u>-</u>	<u>1,041,597</u>	<u>-</u>	<u>1,041,597</u>

31 December 2010	Level 1 Rs. 000	Level 2 Rs. 000	Level 3 Rs. 000	Total
Financial Assets				
Securities at Fair Value through Profit or Loss	183,729,813	-	-	183,729,813
Available for Sale Investments	346,935,603	-	-	346,935,603
Unallocated Gold	1,886,602	-	-	1,886,602
	<u>532,552,018</u>	<u>-</u>	<u>-</u>	<u>532,552,018</u>

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 2011 was Rs.14,089 Mn (2010 – Rs 18,400 Mn) and there were no CBSL Securities sold under agreements to repurchase (2010 - Rs. 95,054.891 Mn). The carrying value of Sri Lanka Government Securities Purchase under agreements to resold as at 31 December 2011 was Rs.19,464 Mn (2010 – Rs Nil)

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.

Determination of Fair Value and Fair Value Hierarchy

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

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

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

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

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

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.

42. Comparative Information				Local Currency Financial Assets	
		2010			(b) Other Assets
As reported previously:		Rs. 000			4,695,913
Foreign Currency Non-Financial Assets					3,701,186
Securities Denominated in Gold (a)		54,007,207			
Local Currency Financial Assets					
Other Assets (b)		1,272,621			
Local Currency Non-Financial Assets					
Sundry Assets (b)		4,170,077			
		5,442,698			
Current Presentation:	2011	2010			
	Rs. 000	Rs. 000			
Foreign Currency Financial Assets					
(a) Unallocated Gold	13,150,196	1,886,602			
Foreign Currency Non-Financial Assets					
(a) Securities Denominated in Gold	43,819,156	52,120,605			
	56,969,352	54,007,207			
Nature of transaction			2011	2010	
			Rs 000	Rs 000	
Transactions:					
Investment Portfolio of Sri Lanka Government Securities Held by CBSL, (a)			164,421,564	20,497,816	
Outright sales of Government Securities			-	3,450,000	
CBSL and Government Securities Purchased / Sold under Agreement to Repurchase / Sales			7,792,273,174	6,175,811,262	
Cost of Printing currency notes, for the year ended 31 December (d)			1,222,901	692,036	
Guarantees provided by CBSL, as at 31 December (Note 44.2)			2,152,831	1,691,623	
Payments for Goods, Services and Taxes, during the year ended 31 December 2011 (e)			400,057	371,626	
Paid Surplus to Government, during the year (Note 27)			22,000,000	15,000,000	
Advances to Government, (Note 8)			94,743,013	77,878,823	
Government Securities held for specific purposes			1,232,281	1,209,345	
Gross Foreign Exchange Transactions during the year, (g)					
Sales			347,065,137	135,934,558	
Purchases			30,734,653	30,697,765	
SWAP			11,593,125	115,551,442	
Refinance (i)			4,506,581	3,425,470	
Loans given under Sushana 1 & 2 & Provincial develop. Credit scheme			2,052,734	2,053,518	
Advance payment to CWE for the acquisition of National Mutual Assurance Building			-	175,000	
External legal expenses (k) (Note 32)			324,371	-	
Funds Received in respect of Abandoned Property, during the year			-	494,705	
Outstanding Balances:					
RTGS Balances with Banks & Financial Institutions			75,130,539	58,100,065	
Receivable from Treasury and other Ministries			2,399,849	2,377,257	
Receivable from Ceylon Petroleum Corporation (k)			480,814	221,293	
Payable to Ministry of Finance & Planning (Note 17)			53,359,431	-	
Current Account Balances with Government & Government Entities as at 31 December			1,643,525	2,987,422	
Other Transactions & Balances (m)			937,270	793,684	

Reasons for change in the presentation and classification:

Above classifications were made in the financial statements of the Bank for better presentation.

43. Related Parties**43.1 Transactions with State and State Controlled Entities**

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

<p>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 2011 are given in Note 18 and 19. Interest earned on the investment portfolio is given in Note 28.</p> <p>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 2011, 8 licensed commercial banks & licensed specialised banks which had been funded by the government or has a significant influence, came under the supervision of the department.</p> <p>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.</p> <p>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.</p> <p>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.</p> <p>e) In carrying out the normal operations, the Bank enters into transactions to obtain various goods and services with government entities or entities in which government has significant influence or control.</p> <p>f) The Bank commonly acts as trustees and in other fiduciary capacities that result in the holding or placing of assets and liabilities on behalf of government, trusts, retirement benefit plans and other institutions, as explained in Note 45.</p>	<p>g) International Operations Department of the Bank monitors the development in the domestic foreign exchange market and overnight net foreign exchange open positions of commercial banks. In monitoring the domestic foreign exchange market developments, the Bank is on both sides of the market to moderate the excessive volatility in the exchange rate of Sri Lanka Rupee. The amounts of purchases and sales of foreign exchange represents results of such monitoring activities.</p> <p>h) The Bank also had custodial arrangements with one State-controlled bank, for which no charges were levied.</p> <p>i) The Bank provides refinance loans and for which credit guarantees also provided as described in note 44.2 of which CBSL funded projects amounted to Rs. 4,506.581 Mn (2010 Rs 3,425.47 Mn) and government funded projects amounted to Rs. 2,974.412 Mn (2010 - Rs. 2,751.978 Mn)</p> <p>j) As per the circular issued by Director Bank Supervision, the banks who do not maintain the minimum advance limit of 10% to agriculture, contribute the shortfall to refinance fund operated by RDD of the bank. Accordingly during the year SMIB bank has remitted Rs. 352.57Mn. During the year RDD has generated Rs. 347.715 Mn loans under the refinance scheme to Peoples Bank (217.337 Mn), BOC (28.66 Mn) Pradeshiya Sanwardana Bank (93.638 Mn) and Lankaputhra Development Bank (8.08 Mn) & for which RDD has received an interest of Rs. 3.730 Mn.</p> <p>k) Upon the request made by the Hon. Attorney General, CBSL made legal fees to foreign lawyers who appeared on behalf of Ceylon Petroleum Corporation (CPC). These payments amounting to Rs. 480.814 Mn (2010 - Rs. 221.293 Mn) considered as receivable from CPC.</p> <p>Further during the year CBSL has paid Rs. 324.370 Mn as legal fees for foreign lawyers who appeared in the arbitration proceedings on hedging case initiated by Deutsche Bank AG against Democratic Socialist Republic of Sri Lanka. (Note 32)</p> <p>l) Out of the International sovereign Bond issue in July 2011, USD 500 Mn has been retained in a special account in the bank as per the request made by the Treasury. The balance in this account utilized to discharge the debt service obligations of Government Treasury due in October & November 2011. USD 181.141 Mn used to discharge Interest & Principal Payments of Foreign Loans & USD 256.563 Mn used to discharge Interest payments of Treasury Bills and Coupon, Interest/discount & Principal Payments of Treasury Bonds & Rupee to the investors other than EPF, ETF & NSB. After discharging the above debt service obligations of Government Treasury rupee equivalent of remaining funds, amounting to USD</p>
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62.296 has been returned to DST's A/C 4201 on 30 November 2011.

- m) Other Transactions & balances include the transactions and balances carried out with individual government & government departments, state control entities that are not individually significant. The nature of the transactions are Guarantees provided by CBSL Rs. 120.607 Mn (2010- Rs. 103.827Mn), funds collected in respect of exchange control activities Rs. 25.031 Mn (2010- Rs. 8.942 Mn), government securities held for specific purpose Rs. 69.535 Mn (2010- Rs. 63.276 Mn), RTGS balance of NSB Fund Management Rs. 0.117 Mn (2010- Rs. 0.368 Mn), Loans given under Susahana 1 & 2 and Provincial Development Credit Loan Scheme Rs 120.481 Mn (2010- Rs. 218.547 Mn), Payments for Goods, Services and Taxes, during the year ended 31 December 2011 Rs. 334.437 Mn (2010- Rs. 228.058 Mn), current account balances of government & government entities Rs. 155.505 Mn (2010-Rs. 101.236 Mn) and Funds Received in respect of Abandoned Property Rs. 74.076 Mn (2010 -Rs. 69.429 Mn).

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

During the year the Bank received an amount of Rs. 11.851 Mn (2010 – Rs. 6.944 Mn) as dividend income from investments it has given in Note 10.

43.3 Transactions with Key Managerial Personnel

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

Compensations to the Key Management Personnel

	2011 Rs 000	2010 Rs 000
Short Term Employee Benefits	44,012	73,833

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

43.4 Other Transactions with Key Managerial Personnel

	2011 Rs 000	2010 Rs 000
Loans to Key Management Personnel	29,835	27,123

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

43.5 Transactions with Post Employment Benefit Plans

	2011 Rs 000	2010 Rs 000
Contributions paid and payable	23,288	26,949

The Bank contributed various amounts to Pension and Other Post Retirement Plans as disclosed in Note 40 and there was no necessity to make an interest subsidy payment to the Employees Provident Fund (EPF) in 2011 as the fund recorded a surplus return. In the normal course of business the Bank provides banking and financial services to its post employment plans. Amounts of balances with such plans are given in Note 21.

44. Contingent Liabilities And Capital Commitments

44.1 Financial Guarantee Contracts

The Bank acting as an agent of the government or its agencies and institutions, provides guarantees to various parties on the strength of counter guarantees issued to CBSL by the General Treasury. There were no such outstanding guarantees as at 31 December 2011

44.2 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:

Related Parties	Currency of Guarantee	Outstanding Guarantee Amount	
		2011 Rs. 000	2010 Rs. 000
	Rupees		
- CBSL Funded Projects		490,556	717,273
- GOSL Funded Projects		1,782,882	1,078,177
Others	Rupees		
- CBSL Funded Projects		410,629	557,552
- GOSL Funded Projects		576,177	287,211
Total Credit Guarantees		3,260,244	2,640,213

44.3 Fiduciary Activities

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

44.4 Legal Claims

The Bank is a defendant in 04 cases where legal actions instituted by stakeholders of entities involved, claiming Rs.37 Mn with legal interest. These cases are being contested by the Bank and no provision has been made in the financial statements. Out of these cases 02 cases have been handed over to Sri Lanka Insurance Corporation for reimbursement of the damages.

The Bank is a plaintiff in 04 cases claiming Rs 12.069 Mn with legal interest for the damages.

Further, there were a number of legal proceedings outstanding against the Bank as at 31 December 2011 claiming No provision has been made, as the bank is of the opinion that it is unlikely that any significant loss will arise.

44.5 Commitments

- As at 31 December 2011 the Bank has capital commitments of Rs. 128.907 Mn and Euro 0.195 Mn (2010 – Rs. 54.134 Mn), in respect of the acquisition of Property, Plant and Equipment.
- As at 31 December 2011 outstanding Forward exchange transactions as follows,

Forward exchange contracts	2011 000	2010 000
Forward exchange sales		
AUD	265,000	-
GBP	170,000	-
USD	213,000	-
	<u> </u>	<u> </u>
Forward exchange purchases		
AUD	567,800	-
GBP	766,500	-
USD	25,000	-
LKR	23,142,000	-
	<u> </u>	<u> </u>

44.6 Assets Pledged

In order to facilitate the securities settlement process, AUD 55 Mn (carrying value AUD 55.176 Mn) worth of securities (2010– AUD 39 Mn & GBP 10 Mn -Carrying value -AUD 21.096 Mn & GBP 10.031 Mn) have been pledged by the Bank to the Euro Clear Bank and obtained a credit facility of USD 35 Mn (2010 – USD 35 Mn). The pledged securities are held in a separate account at the Euro Clear.

Those securities are presented in the financial statement of

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

44.7 Contingent Liability against Sovereign Residencies

As per the lease agreement entered between the Monetary Board of the Central Bank of Sri Lanka (CBSL) and S.W.R.D.Bandaranayake National Memorial Foundation to operate Sovereign Residencies, the subsequent investments made by the lessee to the premises should be agreed by both parties and be recorded. In the event the agreement is terminated the CBSL, as the lesser would have to pay an agreed percentage of the value of the investment based on the year of operation. At the end of the 31 December 2011 the contingent liability of the CBSL as the lesser is estimated at Rs.17.546 Mn (2010 - Rs. 21.932 Mn) being the 40% of the investment value considered at the end of third year of operation.

45. 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:

- The Bank handles disbursements and repayments of various foreign loans and, grants under foreign funded development projects and credit schemes on behalf of the Government of Sri Lanka (GOSL). It also collects counter party funds under various foreign loans and grants on behalf of GOSL and invests such funds in treasury bills on requests made by donor agencies.
- 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.
- Bank administered the Deposit Insurance Scheme, which was a voluntary deposit insurance scheme open to banking institutions licensed by the CBSL and cooperative societies registered under the Cooperative Societies Law No 5 of 1972, which carry on banking business & with effect from 01st October 2010 funds have been transferred to the Sri Lanka Deposit Insurance scheme which was formed as per gazette no:1673/11 -28 September 2010.
- Bank carries out regulatory and supervisory functions in respect of registered finance companies (FCs) and attends to related matters under the authority delegated to it by the Monetary Board. While carrying out such

functions, with respect to failed FCs, various actions are taken, including the vesting of assets of persons responsible for the unviable and insolvent condition of such companies, with the Monetary Board as a form of security.

- e) As per the gazette no:1673/11 dated 28th September 2010, Bank has established a Mandatory deposit insurance scheme filled Sri Lanka Deposit insurance scheme w.e.f 01st October 2010. All Liscenced commercial banks, Liscenced Specialized banks (LSBs) & Registered Finance companies shall be the members of this scheme. The deposits to be insured include; the demand, time & savings, deposit liabilities of the member institutions excluding all borrowing instruments are insured with specific exclusions as per 5.2 of the said gazette notification. The deposit insurance fund has been created with the transfer of Rs.331.653 Mn of the investments of Voluntary Deposit Insurance scheme & Rs.282.337 Mn of investments made out of collections from LCB's as abandoned property. The amount of compensation payable to a depositor shall be limited to Rs.0.2 Mn or its equivalent in the case of foreign currency deposits if such amount exceeds Rs.0.2 Mn. The payment of compensation shall not be a liability of the Monetary Board or the Central Bank of Sri Lanka, & shall be limited to funds available or raised in the Deposit insurance fund including any borrowings permitted & contributions received. The Monetary Board & the Central Bank of Sri Lanka shall not be responsible for any liability that exceeds the total amount lying to the credit of the fund.

The unit established in the Bank supervision dept, is responsible for operation & management of the scheme and maintain separate books & accounts distinctly separate from the Financial statements of the

bank & the Auditor general should be the Auditor.

- f) As per the circular issued by Director Bank Supervision, the banks who do not maintain the minimum advance limit of 10 % to agriculture are required to, contribute the shortfall to refinance fund operated by Regional Development Department (RDD) of the bank. Accordingly during the year SMIB bank has remitted Rs. 352.57 Mn. RDD refines such amounts collected through Bank of Ceylon & Peoples' bank to agriculture under Viskam refinance scheme. The total collections outstanding as at end of the 31 December 2011 amounted to Rs.1,111.574 Mn (2010- 732 Mn). As at end of December 2011 RDD has granted Rs. 347.715 Mn loans under the refinance scheme and received an interest of Rs. 3.730 Mn for loans given. RDD held Rs. 879.5 Mn (2010- 780.268 Mn) of investments in government securities. Further Rs.12.966 Mn (2010- 48.942 Mn) of income earned from the investments.
- g) A Facility Agreement between China Development Bank Corporation (CDB) and Government of Sri Lanka was signed on 31 March 2011 for USD 500 Mn. According to the Facility Agreement, as Escrow Agent, an Escrow Account has been opened in the Central Bank of Sri Lanka for the sole purpose of deposit of the Loans, which account shall be jointly operated by the lender and the borrower pursuant to this Agreement. (Note 17)
- h) Regional Development Department of the Bank on behalf of the Monetary Board acts as the exclusive agents with regard to the following foreign funded projects. In which required the Monetary Board enters into an agreement with the government of Sri Lanka clearly demonstrating the rights and obligations of the Bank.

Concluded Projects for all sectors in the country								
Name of the Project	Total allocation of the fund (Mn)		Purpose of the loan	Refinance granted to PFI s (Rs. Mn)	Salient Features	Warranties & Assurance	General Conditions	Special Conditions
Tea Development Project	USD	24.50	Increase tea small holders income and improve the natural environment in the project areas	2,550.90	Collection of refinance from PFIs as per scheduled date and transferred to DST on conclusion	No warranties and assurance	Financial Statements should be audited by external auditors	The rights and obligations of the agreements will not be assigned, amended, abrogated or waived without the agreement of all relevant parties
Second Perennial Crop Development Project	SDR	11.56	Commercialisation of the perennial crop sector, increase production, nursery development post harvest handling, processing and marketing	1,453.11				
Plantation Sector Reform Project	USD	40.00	To support policy and institutional reforms in the tree crop sub-sector to increase the productivity and profitability and maintain the competitive advantage of the tree crop industry of Sri Lanka.	5,200.00				
Susahana Loan Scheme	LKR	30,000.00	Resumption of enterprises affected by Tsunami	2,750.00	When recovery received from PFIs, funds should be transferred to FD			
Susahana Finance & Leasing Co.	LKR	352.69	Resumption of enterprises affected by Tsunami	351.06	Collection of refinance from PFIs as per scheduled date and transferred to DST on completion			
Small Business Revival Programme	LKR	2,656.00	Resumption of SMEs affected by Tsunami	2,663.40				
Small business Revival Programme Revolving Fund	LKR	150.00	Resumption of SMEs affected by Tsunami	122.72				
Skill Development Project	LKR	94.31	Improve quality and relevance of skill training programme to build high quality workforce and address skill mismatching	94.59				
Urban Environment Infrastructure Development Project	USD	4.00	Improve environmental facilities, health and sanitary conditions of the people living in urban and semi – urban areas.	369.15				
Housing Guarantee Low Income Housing Shelter Project	USD	25.00	To assist low income community in the country to build houses, renovation and expand their residencies.	1,362.00				
Urban Development Low Income Housing Project	SDR	15.10	To provide capital to support low income households for housing improvement	1,915.76				
North Western Province Water Resource Development Project	USD	1.80	Improve economic, social and nutritional well-being of the people living in the project areas	102.76				
Mathale Regional Economic Advancement Project	SDR	2.00	Permanent rising and sustaining of income of small entrepreneurs	249.06				
Mid Country Perennial Crop Development Project	SDR	11.56	As the production of perennial crops in the mid country area.	642.00				
Agriculture Rehabilitation Project	SDR	17.05	To rehabilitate persons and property affected by the civil disturbances in the Northern and eastern provinces and five bordering districts.	843.00				
Small Holder Tea Development Project	USD	12.60	To develop small holder tea sector and rehabilitate tea facilities.	645.93				
Poverty Alleviation Micro Finance Project	YEN	1,368.00	Setting up of an effective credit delivery mechanism for channeling formal credit to income generating activities	1,402.45				
Small Farmers Landless Credit Project	USD	17.40	To establish a cost effective and sustainable micro credit delivery system to generate employment and improve saving habits among the low income receiving people	345.69				
Kegall Integrated Rural Development Project	SDR	1.50	Uplift the standard of living of the people in the project areas by promoting income generating activities	148.00				
Southern Province Rural Development Project	SDR	27.90	Improve the quality of the life of the people in the southern province	564.00				
Mathale Regional Economic Advancement Project Revolving Fund	LKR	77.00	To raise the income of rural and farm families and to provide funds for medium scale entrepreneurs to create	65.42				
Susahana II	LKR	500.00	Providing credit facilities to resume MSMEs affected by the Tsunami	105.54	Funds should be transferred to FD			
Krushi Navodaya	LKR	3,000.00	Provisioning and capital to improve the agriculture base income generating avenues	2,334.85	Subsidy scheme (subsidy paid by the GOSL to PFIs)			

Ongoing Projects									
Name of the Project	Total allocation of the fund (Mn)		Purpose of the loan	Refinance granted to PFI s (Rs. Mn)	Salient Features	Warranties & Assurance	General Conditions	Special Conditions	
Viskam Loan Scheme	LKR	1,111.00	To ensure the availability of credit for investment, diversification and improvement of commercial agri business activities. (development of commercial agri business activities).	356.03	After concluding the projects, funds should be transferred to PFIs as per instructions given by the D/BSD	No warranties and assurance	Financial Statements should be audited by external auditors	The rights and obligations of the agreements will not be assigned, amended, abrogated or waived without the agreement of all relevant parties	
Post Tsunami Coastal Rehabilitation Resource MGT project	SDR	2.09	To support income generating activities directly & indirectly affected by Tsunami.	12.79	Collection of refinance from PFIs as per scheduled date and transferred to DST				
Abiurdi Loan Scheme	LKR	5,000.00	To develop daily farming, milk processing industries, agriculture crop processing industries, cold stores & block ice manufacturing plants and poultry sector.	1,927.40	Subsidy scheme (subsidy paid by the GOSL to PFIs)				
Saubagya Loan scheme	LKR	2,919.00	To start-up, expand any MSMEs or re-start the disaster affected MSMEs	1,994.40	Collection of refinance from PFIs as per scheduled date and transferred to relevant accounts of the RDD on completion				
Self Employment Promotion Initiative Loan Scheme	LKR	73.00	To provide financial assistance to trained youth who passed out from recognized vocational training institutions in the country for establishment of their own self employment projects.	66.85	Collection of refinance from PFIs as per scheduled date and transferred to DST on completion				
Small Plantation Entrepreneurship Development Loan Scheme	SDR	1.75	To enhance the living standard of the low income community in Nuwera Eliya, Kandy, Kegall and Moneragala.	25.56					
Sabaragamuwa Province Integrated Rural Development Project Phase i	LKR	100.00	To enhance and start new income generating activities in the Sabaragamuwa Province.	38.47					
Sabaragamuwa Province Integrated Rural Development Project Phase ii	LKR	70.00	To enhance and start new income generating activities in the Sabaragamuwa Province.	95.64					
Tea Development Project Revolving Fund	LKR	1,100.00	To development of the tea sector in the country	725.37					
Second Perennial Crop Development Project Revolving Fund	LKR	1,000.00	To provide credit facilities to perennial crop sector in the country.	1,023.62					
EIB Contract B Loan Scheme	EUR	10.00	To reconstruction of SMEs directly affected by Tsunami.	1,553.27					
Construction Sector Development Project	EUR	9.00	To strengthening the financial and technical capacities of private local businesses to effectively participate in construction and public works in post Tsunami reconstruction.	1,372.73					
Awakening North	LKR	2,000.00	To develop micro and small enterprises located in the Northern Province.	2,000.00					Collection of refinance from PFIs as per scheduled date and transferred to relevant accounts of the RDD
Development of Eastern Province	LKR	1,000.00	To develop micro and small enterprises located in the Eastern Province.	1,000.00					
Provincial Development Project	LKR	2,900.00	Provisioning capital to medium and long-term projects in the SME sector in the country.	2,394.71	Funds should re-transferred to Finance Department				
Small Farmers and Landless Credit Project 2- Revolving Fund	LKR	310.17	Promote the intensification of agriculture production by small farmers and the establishment of small scale non-farming rural enterprises	596.58	Collection of refinance from PFIs as per scheduled date and transferred to relevant accounts of the RDD				
Poverty Alleviation Micro finance Project I - Revolving Fund	LKR	600.00	Strengthening of economic conditions of low income families	1,407.19					
Dry Zone Live hood Support & Partnership Programme	LKR	200.00	To provide facilities to income generating activities	168.77					
Poverty Alleviation Micro finance Project II - (Probodini)	YEN	2,575.00	Enhancement of the living standard, monthly income less than Rs. 15000/- in project location	2,027.19	Collection of refinance from PFIs as per scheduled date and transferred to DST				
National Agribusiness Development Programme	LKR	9.90	To assist smallholder producers and the landless, especially the youth by increasing the incomes of the beneficiaries in the market/value chain development and providing financing and training for employment to the landless especially the youth to improve their income						

46. Events Occuring Subsequent To Balance Sheet Date

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

2. BANK SUPERVISION

The regulatory and supervisory function relating to banks licensed by the Monetary Board is carried out by the Bank Supervision Department (BSD). The supervision of banks is based on internationally accepted standards for bank supervision set out by the Basel Committee for Banking Supervision. Key objective of the BSD is to promote the soundness of the banking system through formulating and implementing prudential regulations, conducting continuous supervision and periodic statutory examinations of banks to ascertain their true position. Supervision helps to protect the public against mismanagement, bank failures and loss of confidence in the banking system. BSD is also charged with the responsibility of administering the mandatory deposit insurance scheme. As at end 2011, the banking sector in Sri Lanka comprised 24 licensed commercial banks (LCBs) and 9 licensed specialized banks (LSBs). The names of these banks are provided in Annex I. A summary of the main activities performed by BSD during 2011 are provided below.

2.1 Issuance of Prudential Requirements and other Regulations

New prudential regulations and several amendments to existing regulations to licensed banks were introduced with the approval of the Monetary Board in 2011, details of which are provided in Part III of this Report. A summary of the major prudential regulations is given below.

- (a) **Risk management standards on exposure to stock market:** The Board of Directors of banks to set internal limits on exposures to stock market based on tolerable levels and in line with the bank's risk management framework and to maintain the total exposures to margin trading on shares within such limit.
- (b) **Integrated Risk Management (IRM) framework:** The banks to adopt a specific IRM framework to identify, control and mitigate risks in compliance with guidelines issued under this Direction in addition to risk management principles and rules required in regulatory and supervisory procedures and other market best practices of bank risk management.
- (c) **Identifying the SME portfolio:** Expanded qualifying criteria to maximum credit exposures of Rs. 200 mn and annual turnover not to exceed Rs. 600 mn and excluded the availability of latest audited accounts of the credit facilities less than Rs. 50 mn to identify SME portfolio when computing the capital adequacy ratio of banks.
- (d) **Customer Charter:** A customer charter was issued covering customer awareness of banking products/ services, and their terms and conditions, compensation for withdrawal/cancellation of products/services by banks, customer protection from agents of banks, compliant measures and relief and customer obligations toward banks. All licensed banks are required to adopt a 'Code of Conduct' in line with the charter.
- (e) **Designation of Renminbi:** With the approval of the

Minister of Finance, Renminbi (Chinese Currency) was designated for foreign exchange transactions in both Domestic Banking Units and Off-shore Banking Units of Licensed Commercial Banks.

- (f) **Increase in the annual licence fee:** The annual licence fee was increased to be levied on the basis of the total assets of the banks at the end of the previous year, as indicated in the following table. Accordingly, a total of approximately Rs. 252 million is expected as licence fees for the year 2012.

Total assets as at the end of previous year	Annual Licence Fee
Above Rs. 200 bn	Rs. 20 mn
Rs. 125 bn to Rs. 200 bn	Rs. 15 mn
Rs. 75 bn to Rs. 125 bn	Rs. 10 mn
Rs. 25 bn to Rs. 75 bn	Rs. 5 mn
Less than Rs. 25 bn	Rs. 2 mn

- (g) **Display of Information:** The required disclosure on interest rates of deposits and lending products and exchange rates was extended with additional details of fees, commissions and other service charges in all branches, other banking outlets and banks' websites.

2.2 Approvals for Banks, Branches and other Banking Outlets

- (a) Approvals were granted for opening 169 new branches, 145 extension offices (EOs) and 252 student savings units; relocation of 49 branches and 25 EOs; upgrading of 36 EOs to fully fledged branches and installation of 129 off-site Automated Teller Machines (ATMs). Accordingly, there were 2,091 branches, 4,030 other banking outlets and 2,237 ATMs in operation as at the end of 2011.
- (b) Two banking licences were issued, i.e., one to Amana Bank Limited in January 2011 to function as the first commercial bank on Islamic banking principles in Sri Lanka, and another to Axis Bank Limited of India in October 2011 to establish a branch in Sri Lanka. Two letters of provisional approval for establishing a commercial bank and a specialised bank were also issued to Cargills Agriculture and Commercial Bank in September 2011 and to the Merchant Bank of Sri Lanka in April 2011, respectively.

2.3 Continuous Supervision of Banks

BSD continued to perform continuous supervision, which entails the ongoing monitoring of banks to identify early warnings on adverse developments and corrective actions required. The information gathered through regulatory reporting system, spot examinations and other reliable sources provided input for this supervision. Further, an internal supervisory rating system was developed to focus on speedier corrective actions. Several meetings were held with Boards of Directors, senior management and external auditors of banks to ensure corrective actions on supervisory concerns.

2.4 Examination of Banks

BSD conducted examinations of 17 banks that continued from the previous years and examinations of 17 banks that commenced in 2011. Accordingly, the examinations of 20 banks were completed in 2011 through formal discussions with the management of the respective banks and submission of reports to the Monetary Board, while 14 examinations were in the process of completion. During these examinations, concerns on credit risk management, treasury operations, operational risk management and violations on statutory regulations were highlighted. In addition, several examination of limited scope were also carried out on timely issues. A quarterly follow-up of progress was carried out to ensure that corrective actions on key supervisory concerns are taken as agreed.

2.5 Bank Chief Executive Officers' Meetings

BSD continued to function as the secretariat for the Governor's monthly meetings with the Chief Executive Officers (CEOs) of licensed banks. This serves as a forum for exchanging views between the Central Bank and the banking industry. At these meetings, CEOs were apprised of the banking sector performance and economic and monetary developments to facilitate their decision making. Among the matters discussed at these meetings were issue of new currency note series, creation and operation of Investment Fund Accounts for the purpose of utilisation of proceeds of tax savings on banks, outsourcing of business operations, banks' exposures to stock market activities, customer charter, issues relating to SLIPs transactions, display of information, designation of Chinese Renminbi for banking transactions, adoption of accounting standards LKAS 32, LKAS 39 and SLFRS 7, issues on abandoned property, capacity building in the banking industry, permission to import foreign currency notes and facilitating foreign currency encashment through banking outlets.

2.6 Other Activities

(a) Facilitating the banks' adoption of Sri Lanka Accounting Standards (LKAS) 32, 39 and Sri Lanka Financial Reporting Standard (SLFRS) 7

Commencing 1 January 2012, banks are required to adopt LKAS 32, 39 and SLFRS 7, corresponding to the International Accounting Standards (IAS) 32, 39 and International Financial Reporting Standards (IFRS) 7, respectively. During 2011, the Central Bank continued to facilitate the smooth adoption of these Standards by banks as follows:

- (i) Formulated guidelines for reporting comparative financial statements in the annual financial statements of 2012 through the special task force comprising representatives from the Sri Lanka Banks' Association (SLBA), Institute of Chartered Accountants of Sri Lanka (ICASL) and the Central Bank.
- (ii) Issued draft Guidelines on statutory reporting by banks to the Central Bank.
- (iii) Continued discussion with the Sri Lanka Banks'

Association (SLBA) and banks on implementation issues.

- (iv) Assessed the preparedness of banks on adoption of LKAS 32, 39 and SLFRS 7 periodic basis.

(b) Actions on Prohibited Schemes and Litigation

The investigations into prohibited schemes specified in Section 83C of the Banking Act continued. BSD handled 9 cases under prosecution pertaining to the prohibited schemes filed in Magistrate's courts of Anuradapura, Balapitiya, Maho, Panwila, Kurunegala, Attanagalla and Minuwangoda in collaboration with the Attorney General's Department and law enforcement authorities.

(c) Other Litigation

In addition, BSD continued its work relating to litigation and handled 11 court cases relating to the directions issued on corporate governance, affairs of the defaulted Pramuka Development and Savings Bank Limited, exchange control related matters, assessment of fitness and propriety of officers performing executive functions and share ownership in licensed banks filed in the Supreme Court, Court of Appeal, District Court and Labour Tribunal during the year 2011. BSD also assisted the Attorney General's Department to handle international litigation on disputed oil hedging transactions during this stint.

(d) Proposed amendments to the Banking Act

The amendments initiated by the BSD and discussed with the banking community were approved by the Cabinet of Ministers. The amendment bill is currently being drafted by the Legal Draftsman Department.

(e) Inter Regulatory Institutions Council (IRIC)

BSD facilitated the meetings of IRIC. The main responsibilities of IRIC are to ensure the formation of appropriate policy directions for the orderly development of the financial sector and to ensure that all regulatory agencies coordinate and exchange information in the interest of the wider financial system stability. The Council continued to deliberate on the draft Act on "Sharing Information among Financial Sector Regulators". The minimum capital requirement for stock brokers, listing of finance companies in the Colombo Stock Exchange and development of the corporate debt market were other subjects discussed at the Council.

(f) Awareness Programmes

The fourth Bank Directors' Symposium on the theme of "Delivering Stability and Growth in a Challenging Environment" was conducted on 2 November 2011, with a view to enhancing bank directors' awareness on their responsibilities and to update them on new developments in the banking industry and regulatory environment. Advertisements in Print and electronic media in Sinhala, Tamil and English on the list of institutions authorised by the Central Bank to accept

deposits and prohibited schemes of pyramid nature were published to educate the public on the safety of their transactions with banking and other financial institutions. BSD also issued several press releases to disseminate information on changes to the regulatory framework.

(g) Investment Fund Account (IFA)

As proposed in Budget 2011, BSD issued Guidelines to licensed banks on the establishment and operations of the Investment Fund Account for the purpose of utilisation of proceeds of reduction of certain taxes on banks. Commencing 1 January 2011, banks were required to transfer tax savings on account of decline in tax rates amounting to 8 per cent of the profits calculated for the payment of Value Added Tax (VAT) on financial services and 5 per cent of the profits before tax calculated for payment of income tax to the IFA and to invest these funds in long-term Government securities and lend on maturities not less than five years at interest rates not exceeding 5-year Treasury bond yield rates plus 2 per cent margin. Lending can be mainly for agriculture, SMEs, infrastructure, hotels, education and information technology sectors. The total amount transferred by licensed banks to the IFA as at 31 December 2011 was Rs. 12 bn.

(h) Listing of licensed banks

As at end of 2010, there were 8 local private banks listed in the Colombo Stock Exchange. With a view to enhancing the ability of banks to raise additional capital in a more transparent manner and to further improve governance through market discipline, all other locally incorporated private banks were required to list them in the Colombo Stock Exchange by 31 December 2011. One bank listed its shares in the Colombo Stock Exchange whilst another licensed commercial bank which is a subsidiary of a licensed specialised bank, was permitted to list its debentures. The deadline for two banks was extended to May 2012 and December 2013 considering the exceptional circumstances.

Annex II-1

List of Licensed Banks

Licensed Commercial Banks

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

Licensed Specialised Banks

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

3. CENTRE FOR BANKING STUDIES

Centre for Banking Studies (CBS) during the year 2011 continued to play a key role in knowledge sharing and human capital development reflecting the Central Bank's continuous effort and commitment towards building capacity in the financial sector. Accordingly, CBS conducted a series of local and international workshops, seminars, conferences and other knowledge sharing programmes in 2011 which were patronized by participants from the financial sector and real sector institutions, followers of tertiary education and the general public, within Sri Lanka and from the Asian region.

The seminars, workshops and conferences organised by CBS were focused on a variety of key subject areas such as monetary policy, money market operations and financial stability, both from a theoretical and practical viewpoint to create a substantial pool of talents and meet the new demands from the industry. Altogether, a total of 131 programmes which consisted of 72 calendar programmes, 46 special programmes (demanded by various institutions) and 13 international programmes were conducted during 2011. These programmes were patronized by a total of 4,930 participants both local and foreign personnel. The resounding success of the new programmes designed to reach beyond the boundaries of the financial sector with a view to creating a multi-disciplinary approach was the most noteworthy fact of the year 2011 too.

With a view to sharing knowledge of the current interest in the areas of economics, banking and finance, CBS organised a series of public lectures by inviting eminent resource persons from Sri Lanka as well as from foreign countries. At the same time, CBS carried out the CBSL 60th anniversary oration series which commenced in 2010. Special educational programmes were conducted for university academics/students, school children and teachers with a view to share knowledge of the practical aspects of central banking, economic and financial management. In addition, 14 financial literacy/financial inclusion and entrepreneurship development programmes were conducted in different regions of the country for the purpose of enhancing financial literacy and entrepreneurship skills of grass roots level people in the country.

To continue with the knowledge creation and sharing initiative commenced in 2010, the CBS is in the process of publishing 'CBS Journal of Multidisciplinary Studies' (2nd Issue) and it will be released signifying the commitment of CBS in its journey towards a Centre of Excellence in creating and sharing knowledge in the region. Moreover, the learning facilities have been further enhanced in 2011 contributing towards establishing a better learning environment at the CBS.

4. COMMUNICATIONS

The Communications Department (CMD) utilized the year 2011 for adapting and accommodating itself to the futuristic information services of the Central Bank of Sri Lanka (CBSL). The year witnessed the presence of CBSL

in Social Media networks and publishing of the first book in the innovative Cartoon Book Series on "Economics & Finance" intended to enhance the financial literacy among school children. The department propagated its presence by creating an ideal ambience on various major CBSL events and activities. The CMD played a key role in influencing the financial systems to create an enthusiastic economic outlook by promoting, developing, and strengthening effective communications and collaborations between the stake holders of the economy.

4.1 External Communication

CMD continued to improve and maintain its most prominent external communication tool, the trilingual website in a way that accomplishes the department's mission of providing real time information on the Bank's policies and strategies to its stake holders.

Witnessing the success of the department's effort to make the website a popular information source that communicates the Bank's affairs to the public, the site received 71 million visits during the year which was a 20 per cent increase compared to 59 million visits recorded for 2010. Moving on with the global trends, the department enhanced the Bank's web presence with its introduction of the Bank into social media networks such as Facebook, Twitter and You Tube in October 2011, which saw an instantaneous success. Since then, 339 news items were either posted or tweeted on Facebook and Twitter while 19 video clips were uploaded to YouTube. The on-line sales of currency notes and coins also saw a significant increase marking the website's success in taking Sri Lankan currency to numismatists across the world.

The CMD issued 1,758 press releases and 16 gazette notifications while publishing 342 advertisements in print and electronic media, during the year. Out of those 1,758 press releases, 1,248 were on regular topics such as oil prices, exchange rates, Sri Lankan Inter Bank Offer Rates (SLIBOR), Open Markets Operations, call money and weekly economic indicators. Others were on various events and issues relevant to key departments of the Bank such as the Employees' Provident Fund, Bank Supervision, Non-Bank Financial Institutions Supervision and Currency. The department organized 63 media conferences and one-on-one interviews to communicate the views of the Monetary Board to the general public. In addition, the department provided media coverage to the programmes facilitated at the CBSL and CBS. CMD made an immense contribution to the success of several events held in remote areas such as the issuing of the new currency notes series at the Deyata Kirula exhibition in Buttala, opening of Rice Flour Factory at Veyangoda, and Development Programmes in Batticaloa, Jaffna, Mullativu, Girandurukotte, Vavuniya, and Medirigiriya etc., during the year.

4.2 Internal Communication

As a means of achieving its strategic objective of enhancing the knowledge and awareness of the Bank staff, the department maintained the "cbsldaily" as a resourceful

internal web portal which was updated with 292 international and local news items during the year, 2011. The site recorded a noteworthy increase in usage during the year. It provided a vast range of information from economic indicators, presentations, announcements and notices to the internal telephone directory for the Bank Staff. Four volumes of "Kauluwa", the official internal newsletter of the Bank, were published in 2011 with increased number of vibrant pages featuring pictures and articles.

The media monitoring division submitted 1,698 news clips, articles and public opinions collected from fifteen national newspapers published in three languages, conveying different public views on the economy and other affairs relevant to the Bank to the top management.

4.3 Public Awareness

The CMD continued its effort in improving the public awareness with special attention to school children and the young generation. A comic book titled "Story of Inflation" was published as a part of this effort, targeting the young generation through a medium much closer to them.

The single episode educational teledrama, "Paninnata Pera", produced by the department was broadcasted in a number of channels in 2011. The drama was aimed at increasing the public awareness on fraudulent financial institutions and the consequences of investing in such unauthorized financial institutions which was a serious concern with regard to the financial system stability in the recent past. The drama which was originally produced in Sinhala was dubbed in Tamil and broadcasted in Tamil medium channels as well. The production received a good response from the viewers and brought positive remarks from the critics.

The CMD participated in three exhibitions representing the Bank during 2011, where the public could enjoy the opportunity to associate with CBSL by purchasing publications and commemorative coins. The stalls of the Bank were among the mostly visited stalls at these exhibitions; Deyata Kirula National Exhibition held at Buttala, Regional Exhibition held at Kinniya and International Book Fair held at BMICH. It should be especially noted that the ceremony organized by the department at the Deyata Kirula Exhibition to mark the launching of the new currency series received much appreciation.

When it comes to represent the success in numbers, the value of the sales of publications was Rs. 5.23 million in 2011, attributing largely to the popularity of new publications such as "Step by Step Guide to Doing Business in Sri Lanka" and "Mudal Ganudenu Banku Katayuthu Saha Arthikaya". Free distribution of publications at the public awareness programmes were also increased by 10 per cent during the year mostly due to increased demand from Government institutions and schools especially in the North and East.

The department organized 38 public awareness / educational programmes during the year targeting

Advanced Level students, school teachers, trainees of armed forces and officers of the commercial banks and in foreign service. Eleven of these programmes were held outside Colombo, i.e. Trincomalee, Matale, Hambantota, Dehiattakandiya, Nochchiyagama, Kurunegala, and Kandy. The programmes were attended by a total of 5,262 participants which was an 8 per cent increase over the previous year.

4.4 Translation Services

As in the past years, the Tamil translation division continued to provide its invaluable service to fulfill the Tamil translation requirements of CBSL. The unit completed 357 assignments related to typesetting and translation amounting to 2,271 pages during the year 2011.

4.5 Printing Press

The printing press also continued its service completing 251 printing assignments ranging up to 5 colours, maintaining its high quality standards. Among these assignments were Strategic Plan of the Central Bank of Sri Lanka, Debt Bulletin, A step by step guide to Doing Business in Sri Lanka, Road Map 2012, Staff Studies Vol. 40, Felicitation volume of Dr. H.N.S. Karunatilake, Financial Systems Stability Report, Economic and Social Statistics, Satahana, News Survey, CBS Programme Calendar, CBS Journal, Central Bank Manual, and Monthly Bulletin. In addition to the above mentioned publications, posters, certificates, forms, invitation cards, file covers, leaflets and pamphlets were printed to fulfill the requirements of the Bank. Also, the Printing Press carried out the page setting and designing of 60th Anniversary publication and Annual Report of the Financial Intelligence Unit. Supporting the public awareness strategic objective of the CMD, the following academic publications were printed and issued under the CMD's copyright; "Money transactions, Banks and Economy", "Analysis of Basic Economic Principles" and "Story of Inflation".

4.6 Photographic coverage of major events of the Bank

2011 was a busy year for the photographic unit of CMD. All the photographic requirements covering internal and external functions such as international conferences, launching of the new series of currency notes, development activities arranged by CBSL and preparation of albums, CDs and framing of photos were accomplished by the unit.

4.7 Library and Information Centre

The Library and Information Centre (LIC) has grown in both quality and quantity making its collection rich of 25,667 books, 17,592 reports, 1,805 CDs and 148 bound volumes as at the end of the year. The LIC provided library services for the Bank staff and for outsiders on request. The Library at the Centre for Banking Studies too increased its collection of books from 5,777 to 5,968.

The usage of the 'Science Direct' database, which gives on-line access to over 100 journals on Economics, Econometrics and Finance was increased during the period under review. The total numbers of foreign and local journals subscribed

by LIC are 119 and 62 respectively. LIC continued to compile electronic publications such as Recent Additions (i.e. new books), Current Contents, News Alert and disseminated them via intranet. A Selective Dissemination of Information (SDI) service was maintained.

The book introducing sessions launched with the objective of cultivating the reading habit among the bank employees continued during 2011 having 5 sessions on books selected to represent a variety of subjects. Economics and Banking Library Network of Sri Lanka (EbanklibnetSL) was maintained and its 24 member libraries were benefited immensely by sharing information via e-mail. LIC organized a book exhibition for the employees in January 2011, where 350 newly purchased titles were on display. A book fair was also organized in December with the participation of 07 reputed booksellers in Sri Lanka. A good response was received for the book exhibition and the book fair.

Digital library service was established giving access to the Bank staff through the Library's Intranet website. The Book Review Competition and Quiz Programme organized to mark the National Reading Month were conducted via e-mail and won the popularity of the staff members.

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

5. CURRENCY

The Currency Department discharges duties under the mandate given to the Central Bank of Sri Lanka (CBSL) by the Monetary Law Act for currency issue and management. In fulfilling this mandate, the Currency Department (CRD) carried out the following activities in 2011.

5.1 Currency (Legal Tender) Issue

The CRD issues both notes and coins to the economy through Licensed Commercial Banks (LCB) by way of new issues and re-issue of serviceables. The value of new and

serviceable (fit) currency notes issued to LCBs in 2011 was Rs.106.1 billion and Rs.229.0 billion, respectively. The 11th currency note series on the theme of "Development, Prosperity and Sri Lanka Dancers" was issued in February 2011. The series consisted of Rs. 20, 50, 100, 500, 1000 and 5000. The official launch of the new series took place on the Independence day 04.02.2011. This new note series won the 2011 Best New Banknote Series Finalist award at the International Association of Currency Affairs (IACA) Conference held in Singapore in October 2011. The value of new and fit coin issues to LCBs was Rs.458.9 million and Rs.13.5 million, respectively. Accordingly, the value of currency notes and coins in circulation as at 31.12.2011 stood at Rs.293.2 billion representing an annual increase of 14.7 per cent over circulation as at 31.12.2010.

5.2 Acceptance of Deposits of Currency

CRD accepts deposits of fit and unserviceable (unfit) currency from LCBs. The fit currency is reissued to LCBs and unfit currency is withdrawn from circulation. Total values of fit notes and unfit notes received through deposits were Rs.258.2 billion and Rs.39.7 billion respectively, in 2011 whereas the value of deposits of coins was Rs. 13.8 mn. Accordingly, the total net values of notes and coins issued were Rs. 37.2 billion and Rs.472.3 million, respectively.

5.3 Commemorative Coins/Notes issues

In terms of provisions of the Monetary Law Act, the Monetary Board is authorized to issue commemorative notes and coins to commemorate any person or a special event.

In terms of the policy approved by the Monetary Board, such issues are made on account of a person who has made a significant contribution to overall well-being of Sri Lanka society or for an event (local or international) which has been an important turning point in Sri Lanka society or to mark a special initiative that could have a significant impact on the well-being of Sri Lanka society. In 2011, five commemorative coins were issued as detailed below. Accordingly, the number of commemorative coins issued by the Central Bank increased to 53.

Description	Face Value (Rs.)	Metal	Diameter (mm)	Weight (g)	Coin Type
60 th Anniversary of Sri Lanka Air Force	2	Nickel plated Steel	28.50	7.00	Circulation Standard
2600 th Anniversary of Sambuddhathwa Jayanthi	1000	Silver	38.61	28.28	Uncirculation Standard
2600 th Anniversary of Sambuddhathwa Jayanthi	10	Nickel plated Steel	26.40	8.35	Circulation Standard
50 th Anniversary of the People's Bank	1000	Silver (Selective Gold plated)	38.61	28.28	Uncirculation Standard
125 th Anniversary of Ananda College - Colombo	2000	Silver	38.61	28.28	Uncirculation Standard

5.4 Counterfeit Deterrence

In order to maintain public confidence in the legal tender, CRD regularly takes several measures to fight counterfeiting. In 2011 new security features were introduced in the 11th series of currency notes to make counterfeiting more difficult. Close co-operation with the Counterfeit Currency Bureau of the Criminal Investigation Department (CID) of the Police and Law enforcement authorities pertaining to counterfeiting attempts continued. As conclusive evidence of imitation of a currency note for proceedings in Courts, 209 Certificates were issued with the Governor's signature. Further, officers of the CRD attended 20 court cases as witnesses on counterfeiting. Counterfeit notes referred by CID to the Central Bank for certification increased marginally to six notes per million genuine notes in circulation in 2011, which is still a much lower level of incidence of counterfeiting compared to many other countries.

5.5 Public Awareness

In order to increase public awareness on security features of currency notes and use of quality notes, CRD carried out the following awareness activities.

- a) Conducted 58 seminars/workshops, participated in 24 radio programmes and 01 TV discussion and published several advertisements in the print media on subjects covering the new series of currency notes, the identification of security features in currency notes and detection of counterfeit notes, good habits of handling currency notes and coins. The audience included bank officers, cash handlers, police officers, school children, government and private sector employees and the general public.
- b) Published 28 articles on currency in the "Mihira" children's newspaper and 8 articles in the special issue on "Currency" in the Central Bank's "Satahana" magazine for educational purposes.
- c) Participated in the national development exhibition of "Deyata Kirula – 2011" held at Buttala from 04th - 10th February 2011 along with its Mobile Museum.
- d) Facilitated 9,219 visitors to Currency Museums of the Central Bank.
- e) A total of 11,825 collector items was sold through the currency museums and the internet. Commemorative coins and notes were also sold through the same channels.
- f) Launched a programme to promote the circulation of clean notes in view of multi-dimensional benefits such as higher quality of notes in circulation, increase in lifespan of notes, consequent reduction of currency issue cost and to improve image of the country among foreigners.
- g) A scheme to collect unfit notes through special programmes and banks, was in the planning process to commence in 2012.

6. DOMESTIC OPERATIONS

The major functions of the Domestic Operations Department (DOD) include conducting of Open Market Operations (OMO); enforcing Statutory Reserve Requirement (SRR) and offering banking services to commercial banks and to the Government.

In addition, Department also offered Intra Day Liquidity Facility (ILF) to commercial banks and primary dealers facilitating smooth settlement of transactions under the Real Time Gross Settlement System (RTGS) to ensure maintenance of an efficient and effective domestic e-payment and settlement system.

6.1 Implementation of Monetary Policy

The Department implements monetary policy through steering short-term interest rate at an appropriate level within the interest rate corridor established by policy interest rates known as repurchase and reverse repurchase rate. This was facilitated by ensuring the availability of liquidity in the inter-bank market to achieve stability in the short-term interest rate (call rate) at the desired level.

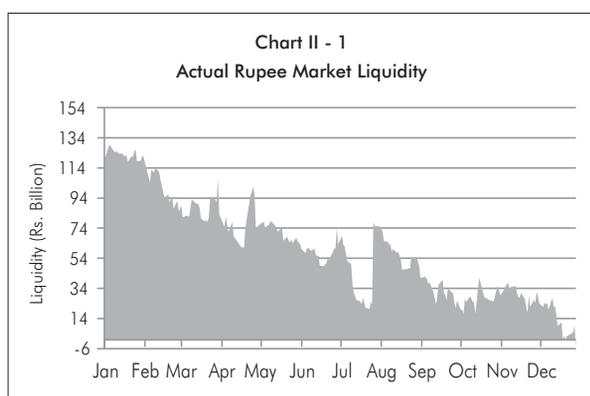
The year 2011 dawned with a large liquidity surplus challenging the Central Bank to find necessary tools to absorb the excess liquidity permanently. Nevertheless, responding to the challenges at the beginning of the year, CBSL relaxed its monetary policy stance further by reducing the policy rates in line with the benign inflation and inflation outlook to support the growth prospects of the domestic economy. Accordingly, repurchase (repo) rate and reverse repurchase (reverse repo) rate were reduced by 25 basis points and 50 basis points to 7.00 per cent and 8.50 per cent respectively, in January 2011. This environment supported the enhancement of credit flow to the private sector significantly, increasing the availability of funds for acceleration of economic activity. Consequently, the economy experienced an expansion in monetary aggregates though on a low base, during the first quarter of the year 2011. Excess liquidity in the domestic money market remained a concern and as significant expansion in monetary aggregates could trigger higher inflation than originally envisaged, the CBSL decided to further recalibrate its policy tools during the first quarter of 2011. Accordingly, SRR applicable to all rupee deposit liabilities of commercial banks was increased by 100 basis points to 8.00 per cent with effect from the reserve week commencing 29 April 2011. This measure was capable of absorbing permanently around Rs.18 billion of excess liquidity from the domestic banking system.

In addition, the sale of foreign exchange in the market by the CBSL, facilitating foreign loan repayments by the Government and expanding credit disbursements by commercial banks were capable of further depleting the excess liquidity in the market. Consequently, the excess liquidity witnessed a gradual decline towards the second quarter of 2011 to one fifth of its peak recorded in the first week of January. However, by end of July 2011, with the utilization of a portion of the proceeds from the fourth international sovereign bond issued by the Government

(with a total value of US dollars one billion or rupees 109 billion) to settle the Government overdraft with the commercial banks, the prevalent rupee liquidity situation received a new thrust.

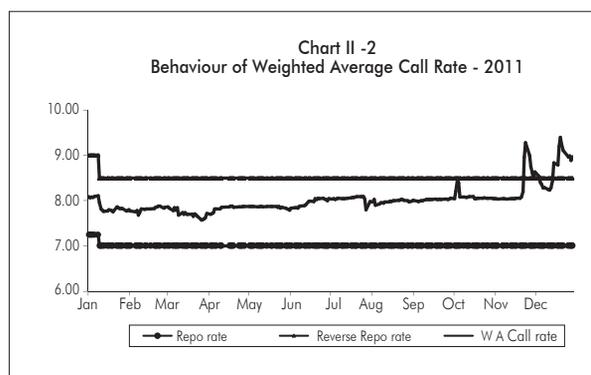
During the periods of overall market surpluses, the majority of surplus market liquidity was absorbed temporarily through the standing facility on overnight basis. The absorption through overnight repo auctions and through foreign exchange swaps (FX swaps) on longer term basis remained at very low level during the year mainly due to temporary cessation of overnight repurchase auction since October 2010. The CBSL experienced a shortage of sufficient Government Securities holding during the first three quarters of 2011. As such, the repo transactions were backed mostly by the securities borrowed under the Government Securities Borrowing Program of the CBSL. Under this program, the bank borrowed up to a maximum of Rs.110 billion worth of government bonds from the Employees' Provident Fund, at any given day, during the period and utilized them as collateral for regular repo transactions. The resultant cost saving on sterilization exercise on to the use of borrowed securities during the period was over Rs.188 million. The programme has allowed an additional return for holders of government securities as they were kept otherwise in idle form until the maturity in most of the instances.

The excess liquidity position that prevailed during the first 3 quarters of the year has gradually eased to end up with a liquidity shortfall position by the end of the year (Chart II-1). Selling foreign exchange in the market by the Central Bank to meet with increased import demand had absorbed around Rs.343 billion worth of liquidity permanently from the banking system. In addition, though the foreign loan disbursement injected Rs.83 billion into the banking system, the repayment of foreign loans had absorbed a further Rs.138 billion making it a net absorption of Rs.55 billion.



The Department aggressively engaged in managing market liquidity using active as well as passive instruments, facilitating the realization of monetary targets while maintaining inter-bank overnight market interest rates within the corridor (Chart II-2). The inter-bank overnight money market interest rate surpassed the upper bound of the corridor at the end of November and continued to stay above the reverse repo rate until end December.

However, the weighted average call market interest rates subsequent to tax adjustments remained within the corridor, though close to the upper bound. Frequent shifting of overall liquidity position between surpluses and deficits while having skewed distribution in market liquidity due to structural issues, prevented liquid banks from lending in the inter-bank market at their full capacity. Moreover, collateral shortages prevented most of the deficit banks from borrowing in the inter-bank repo market or through the central bank reverse repo facility compelling them to borrow at higher rates in the call market.



Domestic money market continued to experience an anomaly in its short-term interest rates as the short-term Treasury bill yields continue to trade below that of the overnight call money rates on continued preference by market participants for safer short-term money market investments. Nevertheless, the CBSL subscriptions to Government securities were increased gradually throughout the year with CBSL holdings recording Rs.168.8 billion as end of 2011. Moreover, the declining liquidity in the rupee market and its skewed distribution exerted an increased pressure on money market interest rates during the latter part of the year leading to high volatility in short-term interest rates. Consequently, deviating from the usual practice, the CBSL conducted reverse repo auctions even in the midst of considerable overall excess liquidity in the rupee market from time to time to maintain stability in the short-term interest rates.

6.1.1 Open Market Operations

a. Overnight Repo Transactions

Overnight repurchase auctions which temporarily ceased in October 2010, were re-commenced on 19 September 2011. This process was continued till end November to absorb surplus rupee liquidity on a daily basis. On average, about Rs.28 billion per day was offered at the auction representing about 86 per cent of liquidity. The weighted average yield rate of overnight repo auction which was 7.08 per cent at the day of re-commencement increased up to 7.58 per cent by end November 2011. Since November, the overnight repo auctions were not necessary as the market was experiencing a new or de facto liquidity shortage.

b. Overnight Reverse Repo Transactions

In the presence of structural imbalances, the gradual contraction of surplus rupee liquidity in the domestic market had created an increased upward pressure on overnight interest rate. Consequently, reverse repurchase auctions were commenced in the first week of October to mitigate pressure on inter-bank money market rates. Though the conducting of such auctions ceased since the third week of October with the easing off of the upward pressure, the auctions were recommenced from mid-December in view of the declining market liquidity. On average, about Rs.11 billion per day was offered at the auction from 16 to 30 December 2011.

6.1.2 FX swap Transactions

The CBSL conducted three FX swap auctions (sell- buy) during the first quarter of 2011, as a tool of absorption of excess liquidity. The total value of swaps used during the year for this purpose amounted to Rs.6,434 million (US dollars 58 million). In addition to swap auctions, one standing FX swap (sell – buy) transaction at value of Rs.4,444 million (US dollars 40 million) was carried out during the year.

6.1.3 Standing Facilities

The Department continued to provide the standing facilities at CBSL Repo and Reverse Repo rates to Participating Institutions (PIs) who were unable to manage their short-term fund requirements fully through the inter-bank money market and the daily OMO auctions.

a. Repo Transactions

With the temporary cessation of auctions under OMO, repos under the standing facility became the key liquidity absorption instrument during the first three quarters of the year. PIs placed their total excess liquidity using standing facility at the repurchase rate on overnight basis until mid-September, 2011. As a result, the average placements under the standing facility during the first eight months of the year stood at Rs.77 billion per day, which was equivalent to 100 per cent of the surplus rupee liquidity in the market. With the re-commencement of overnight auctions in mid-September, standing facility was provided at policy rates to accommodate PIs whose bids were unsuccessful at the daily auction or having excess funds at the end of the day's transactions. Consequently, the repurchase transactions under the standing facility reported an average of about Rs.57 billion per day in 2011.

b. Reverse Repo Transactions

The purpose of the Central Bank's Reverse Repo facility is to fulfill an urgent liquidity requirement of a participant where access to alternative sources of funds is not available. Standing facilities were used to inject required funds at CBSL reverse repurchase rate during the latter part of 2011, consequent to the squeezed market liquidity as well as on its skewed distribution. The total of Rs.27 billion was obtained by PIs under standing facility during the year 2011.

6.1.4 Statutory Reserve Requirement (SRR)

The SRR is a minimum reserve that each commercial bank must hold in terms of the regulations of the CBSL in the reserve account with the CBSL based on the deposit liabilities of each of such bank maintained with the DOD. The applicable rate of SRR was increased to 8 per cent from 7 per cent of rupee deposit liabilities of each of the commercial banks since 29 April 2011 to curtail the domestic excess liquidity fuelled acceleration of monetary expansion.

6.1.5 Bank Rate

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

6.2 Banker to Commercial Banks and the Government

6.2.1 Accounts of Financial Institutions

The DOD provided current account facilities to commercial banks and primary dealers to facilitate inter-bank payments and settlement system as part of Central Bank's role as the banker to commercial banks. As at end of 2011, CBSL maintained accounts for 24 commercial banks and 9 primary dealers including EPF. These accounts were operated on a Real Time Gross Settlement basis within the Automated General Ledger system of the Bank.

6.2.2 Government Accounts

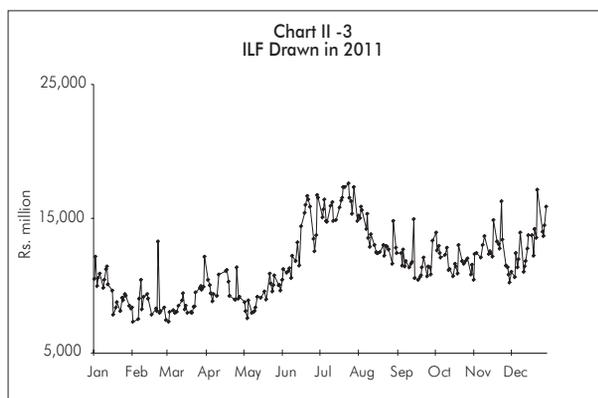
Performing the role of the banker to the Government, the Department maintained the accounts of government departments, agencies, institutions and statutory boards and provided the required banking facilities to them. The total number of such accounts maintained by CBSL stood at 57 as at end 2011. In terms of Section 89 of the Monetary Law Act, CBSL provides provisional advances to the Government free of charge, subject to a limit of 10 per cent of the estimated government revenue of the given fiscal year. During 2011, the amount of provisional advances granted to the Government increased by Rs. 14.6 billion to Rs.98.9 billion from that of the previous year due to the higher Government revenue estimated for 2011.

6.3 Provision of Intra-Day Liquidity Facility (ILF)

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

The total value and average daily value of ILF drawn during the year amounted to Rs.2,779 billion and Rs.11.6 billion, respectively. This shows a marginal increase in the ILF utilization over that of the previous year at Rs.2,747 billion and Rs.11 billion, respectively. Implementing strict

measures such as the penal rate of interest over and above the bank rate and the suspension of the facility for repeated defaults have ensured the prompt reversal of ILF before the close of business of LankaSettle. As a consequence, there were no ILF defaults in any given day during 2011.



7. ECONOMIC RESEARCH

The Economic Research Department (ERD) discharged its responsibilities by providing regular data and information as well as comprehensive analyses on economic matters to the Monetary Policy Committee (MPC), Management and the Monetary Board to facilitate proactive and timely monetary policy decision making to achieve the Central Bank's prime objective of economic and price stability. Through continuous research and vigilant monitoring of domestic and global developments, the ERD identified emerging issues in the economy and recommendations were made to the Management to address those issues. To discharge the Central Bank's role as an economic advisor to the government, the ERD continued to provide constructive recommendations to the management on emerging issues and fiscal policy measures required for maintaining macroeconomic stability and the impact of fiscal policy measures already adopted by the government on the various sectors of the economy. In fulfilling the effective communications requirement, the ERD disseminated monetary policy and other economic information to the general public on a regular basis. Accordingly, the ERD coordinated publishing of all statutory and other reports, issued press releases and released updated information regularly through the Central Bank's website. During the year, senior officials of the ERD participated in various policy advisory committees set up by the government and government agencies and provided advice on various policies pertaining to the economy while observations were given on issues referred to the ERD by various government institutions as well as by other departments in the Bank.

7.1 Conducting Research for Assisting Monetary Policy Formulation

The ERD continued to prepare comprehensive economic and monetary analyses on a regular basis to facilitate proactive decision making on monetary policy by the MPC and the Monetary Board. The MPC was regularly updated on the state

of the economy by providing analysis on global economic developments and its impact on the domestic economy, the developments and issues in key macroeconomic sectors, and financial markets and inflation projections etc. to facilitate making monetary policy recommendations to the Monetary Board. The econometric modelling framework developed by the ERD for forecasting inflation was further improved to forecast long-term inflation trends using longer period time series data and a wider array of explanatory variables. This has helped make more credible inflation forecasts which are essential in formulating monetary policy. The ERD assisted the Census and Statistics Department (DCS) to compile a new core inflation index which was published commencing June 2011. Calculation of the Average Weighted Lending Rate (AWLR), which reflects the movement of interest rates pertaining to all outstanding loans and advances granted by commercial banks to the private sector, on a monthly basis instead of calculating it on a quarterly basis was initiated in 2011. This facilitated more evidence based policy recommendations by the MPC and the release of more frequent information to the public.

For the fourth consecutive year, the ERD successfully completed its International Research Conference in 2011 and it offered a great opportunity to present recent research findings and share views among researchers from regional central banks. The following three officers from the ERD presented their research findings at the International Research Conference.

- (a) "Bank Lending Channel in Sri Lanka: An Empirical Investigation" by Ms. W. A. Dilrukshini.
- (b) "Central Bank Financial Strength and its impact on Economic Outcomes" by Mr. R. A. Anil Perera.
- (c) "Assessing Debt Sustainability in Sri Lanka" by Ms. D. G. D. I. Ekanayaka.

Identifying the necessity of conducting research that could be used in policy formulation, officers in the ERD continued joint research programmes with International Organisations such as the South East Asian Central Banks (SEACEN) Research and Training Centre.

With a view to updating knowledge on emerging issues and also to provide an opportunity for knowledge sharing among the officers, 25 weekly Departmental Seminars were conducted during the year. Officers in the ERD presented their research findings as well as special issues relating to the domestic and global economy at these seminars. Further, the ERD organised a number of special seminars inviting professionals from various sectors to share their knowledge and experiences with bank officials.

The Industrial Survey conducted by the ERD on a monthly, semi-annual and annual basis was further developed in 2011 by expanding the sample coverage, and improving data collection and data analysis to identify emerging trends in the Industrial Sector. Further, the Department successfully completed the revision of the Monthly Industrial Production

Volume Index (MIPVI) from the existing International Standards on Industrial Classification (ISIC) revision II to a more comprehensive ISIC revision IV, to fully encompass the structural changes taking place in the Industrial Sector. As in the previous years, the Survey on Housing Approvals in the Greater Colombo Area was conducted in order to prepare a Housing Approvals Index. The ERD continued to conduct half-yearly and annual Balance of Payments Surveys during 2011 and compiled the Balance of Payments statistics. Further, the Annual Survey on International Investment Position (IIP) was also conducted in 2011. A new trade data classification system as per the National Import Tariff Guide 2010 was introduced while compilation of the new Trade Index with 2010 as the base year was completed during the year. The Agriculture Production Index compiled by the ERD was improved with a new base year in order to reflect the recent changes in the agriculture sector.

The Monetary Policy Consultative Committee (MPCC), which was established to strengthen the monetary policy decision making process by obtaining views of the private sector was facilitated by the ERD to have productive discussions on topical issues and policies. The MPCC in 2011 comprised Mr. Mahen Dayanada (Chairman), Mr. Sohli Captain, Mr. R. M. B Senanayake, Mr. M. P. Jayawardena, Mr. Cubby Wijetunga, Mr. Amal Cabraal, Mr. Sujeewa Rajapakse and Ms. N. S. M. Samarathunga.

7.2 Preparation of Statutory and other Reports/Publications

As required under the Monetary Law Act (MLA), the ERD prepared the Annual Report of the Central Bank for 2010 and presented it to the Minister of Finance and Planning within the stipulated time period with the assistance of other departments of the bank. In addition, Recent Economic Developments - Highlights of 2011 and Prospects for 2012 and Monthly Bulletins were also coordinated and published. As per the requirements under Section 116(1) of the MLA, the September 15th Report was also submitted to the Minister of Finance and Planning incorporating analysis of economic performance during the early months and outlook for 2011, effects of fiscal policy on implementation of monetary policy by the Central Bank as well as some policy proposals, which could be used for the preparation of the National Budget for 2012.

With a view to improving transparency and updating the general public on economic matters, the ERD continued to disseminate policy changes and statistics on monetary policy, balance of payments and international trade and other economic matters on regular basis through press releases. As in the previous years, the policy statement of the Central Bank, the "Road Map, Monetary and Financial Sector Policies for 2011 and Beyond", was prepared and announced to the public on 04th January 2011. The purpose of the Road Map was to enhance the predictability and transparency of the Central Bank's policies which would help stakeholders to design and better calibrate their own plans and strategies for the

period ahead. At the end of the year, a similar policy statement was prepared for 2012 and beyond as well, which was announced on 03rd January 2012.

In 2011, as in the previous years, independent views and recommendations were provided on 90 Cabinet Papers, which had important economic and monetary implications. The ERD continued to evaluate monetary implications of foreign loans that were planned to be obtained by the government and made recommendations to the Monetary Board and provided comments and observations on various other matters referred to by Ministries and Departments.

7.3 Contribution to Knowledge Enhancement and Sharing of Expertise

The ERD contributed immensely to enhance the knowledge on the subject of economics providing its expertise for programmes both within and outside the Central Bank. Officials of the ERD worked as resource persons at various educational programmes organised by institutions such as Centre for Banking Studies (CBS), Sri Lanka Institute of Development Administration (SLIDA), Universities, Schools and various other government and private institutions. Many officers from the ERD participated further, in the media based education programmes organized by the CBS. The officers continued to make presentations on central banking and macroeconomic developments to both local and foreign delegations visiting the Bank. In addition, senior officials of the ERD engaged in evaluation of research papers submitted by postgraduate aspirants of the Central Bank and necessary guidance was given in preparation of research proposals and research papers.

Senior officials of the department served on various Committees and Boards within and outside the Bank. Representations at external committees included: committee on Development of Water Resources of Kalu Ganga Basin including Flood Protection – Project Committee, Technical Evaluation Committee for Environmental Impact Assessment (EIA) of Offshore Oil Exploration in the Gulf of Mannar, Technical Assistance for Sustainable Power Sector Support II, Steering Committee on Rural Household Connection (TA – 7266), Ceylon Electricity Board, the team assigned with the task of formalising and operationalising the establishment of the five hubs (Knowledge, Commercial, Maritime, Aviation and Energy), the working group appointed to address the issues relating to improving the Doing Business Index of Sri Lanka, National Committee on Socio Economic and Policy Analysis at the Sri Lanka Council for Agricultural Research and Policy, International Labour Organization Committee on Analysing Labour and Social Trends in Sri Lanka-2011, Steering Committee on Healthcare Financing, Steering Committee on National Health Accounts and the Financial Sector Monitoring Committee at the General Treasury. In addition, the ERD represented the Bank at meetings conducted by various Ministries including the Ministry of Finance and Planning.

7.4 International Relations

The Department continued to coordinate with multilateral organisations such as IMF, World Bank, the Asian Development Bank (ADB), SEACEN, SAARCFINANCE and SEANZA on behalf of the Central Bank and the Government. The ERD worked closely with IMF staff missions that visited Sri Lanka to review the IMF – SBA facility during the year and discharged the responsibility of regular data reporting under the IMF – SBA facility. The ERD closely monitored the performance criteria given under the IMF SBA facility and possible measures were proposed to the Management and to the Ministry of Finance and Planning to take necessary action to achieve the targets. Also, the Department worked closely with three international sovereign rating agencies namely; Fitch Ratings, S & P Ratings and Moody's Ratings and three Rating Advisors to upgrade the country rating in 2011. Further, required support was given for the successful completion of the sovereign bond issue.

Officers of the ERD also engaged in organising the 46th SEACEN Governors' Conference, High-Level Seminar and 30th SEACEN Board of Governors' Meeting in February 2011. Further, work related to conducting the SEACEN Exco meeting which was held in January 2012 was also carried out during the year. In addition, the SEACEN-IMF course on External Sector Issues was organised by the Department in collaboration with the CBS; which was attended by participants from all SEACEN countries.

8. EMPLOYEES' PROVIDENT FUND

The Employees' Provident Fund (EPF) Department managed the EPF in terms of provisions of the EPF Act No.15 of 1958. The operational activities of the Department include collection of member contributions and surcharges, maintenance of member accounts, investment of surplus funds, payments of benefits to members and their legal heirs and charging the expenditure incurred by the Monetary Board and Commissioner of Labour in the performance of their duties and functions under the EPF Act to the Fund. In carrying out these functions the EPF Department worked in close collaboration with the Commissioner of Labour.

8.1 Membership, Member Balances and Refunds

The total number of member accounts of the Fund increased by 1.5 per cent to 13.6 million by end 2011 compared to 13.4 million recorded at the end of 2010 (Table II-1). The number of contributing member accounts increased by 9.5 per cent to 2.3 million by end 2011 from 2.1 million in 2010 whilst non-contributing member accounts remained at 11.3 million. Meanwhile, the number of contributing employers increased to 66,350 by end 2011 from 62,295 at the end of 2010.

The total value of the Fund surpassed Rs. 1 trillion mark and stood at Rs.1,020 billion by end 2011 compared to that of Rs. 899.7 billion by end 2010 recording a net increase of 13.4 per cent. The income generated through prudent management of the Fund resulted in this sharp

increase in the size of the Fund during 2011. As at end 2011, total liability of the Fund to the members stood at Rs. 986 billion recording a 13.4 per cent increase from Rs. 869.2 billion as at end 2010. This includes the interest payments credited to the member accounts as at end 2011.

The total member contribution also increased by 12.9 per cent to Rs. 61.9 billion compared to Rs. 54.8 billion in the previous year. The total amount of refunds to the members and their legal heirs in 2011 was Rs. 47.3 billion, which was an increase of 35.5 per cent over Rs. 34.9 billion in 2010 while the number of refunds increased by 15.1 per cent over that of the previous year.

Table II-1
Selected Key Indicators of the Fund

Item	2010	2011 (a)	Change (%)
Total number of member accounts (mn)	13.4	13.6	1.5
Contributing member accounts (mn)	2.1	2.3	9.5
Non-contributing member accounts (mn)	11.3	11.3	-
Contributing employers	62,295	66,350	6.5
Total contributions (Rs. bn)	54.8	61.9	12.9
Total refunds (Rs. bn)	34.9	47.3	35.5
Number of refunds	104,528	120,301	15.1
Total liability to members (Rs. bn)	869.2	986.0	13.4
Total value of the Fund (Rs. bn)	899.7	1,020.1	13.4

(a) Provisional

Source: EPF Department, Central Bank of Sri Lanka

8.2 Investment of Funds and Return

(i) **Investment Portfolio:** As at the end 2011, the total investment portfolio (Book Value) of the Fund grew by 13.9 per cent to Rs. 988 billion from Rs. 867.1 billion in 2010 (Table II-2). The investment policy of the Fund continued to focus on providing a long-term positive real rate of return to the members while ensuring the safety of the Fund and maintaining a sufficient level of liquidity to meet refund payments and other expenses of the Fund. Accordingly, 90.8 per cent of the Fund was invested in government securities while 7.9 per cent was invested in equity and 1.0 per cent was placed in corporate debentures. The balance 0.3 per cent was invested in high liquid assets such as Reverse-Repurchase on government securities to maintain liquidity requirement of the Fund.

Table II-2
Investment Portfolio

Type of Investment	2010		2011	
	Rs.bn	Share (%)	Rs.bn	Share (%)
Treasury bonds & bills	774.8	89.4	874.6	88.5
Rupees Loans	40.9	4.7	23.1	2.3
Corporate Debentures	6.3	0.7	9.2	1.0
Equity	43.7	5.0	78.3	7.9
Reverse Repos	1.4	0.2	2.8	0.3
Total	867.1	100.0	988.0	100.0

Source: EPF Department, Central Bank of Sri Lanka

(ii) **Income on Investment:** In view of the decline in interest rates, the total income from investment in 2011 was Rs.116 billion compared to Rs.121.3 billion in 2010 (Table II-3). As in the past, the interest income including amortization gain was the major source of income (97.7 per cent of the income) to the Fund. Income from these two sources declined by Rs. 4.8 billion to Rs. 113.4 billion in 2011 from Rs.118.2 billion in 2010. The capital gains and dividends realized from the equity portfolio increased by 60.9 per cent to Rs. 2,678 million in the year 2011 from Rs. 1,664 million in 2010 mainly due to the declaration of higher dividends by companies. Overall, the rate of return on total portfolio decreased to 12 per cent in 2011 from 15 per cent in 2010 mainly due to decline in the yield rates of government securities. Maturity profile of government securities portfolio is at Table II-4.

Table II-3
Income on Investments

Sources of Income	2010		2011	
	Rs.mn	Share (%)	Rs.mn	Share (%)
Interest Income	89,165	73.5	84,673	73.0
Amortized gain	29,061	24.0	28,727	24.7
Capital gain from Government Securities	874	0.7	10	..
Capital gain from Equity	1,054	0.9	715	0.6
Marked to Market Gain/(loss)	106	0.1	(267)	(0.2)
Dividends	610	0.5	1,963	1.7
Other	386	0.3	222	0.2
Total	121,256	100.0	116,043	100.0

Source: EPF Department, Central Bank of Sri Lanka

Table II-4
Maturity Profile of Government Securities Portfolio – End of 2011

Maturity	Amount Rs. mn	Share (%)
Less than 1 year	177,064	18.6
1-2 years	202,673	21.3
2-4 years	247,582	26.1
More than 4 years	323,154	34.0
Total	950,473	100.0

Source: EPF Department, Central Bank of Sri Lanka

(iii) **Expenditure:** Total operational expenditure of the Fund declined by 4.6 per cent to Rs. 785.7 million in 2011 from Rs. 824.0 million in 2010 (Table II-5). The Fund managed to maintain its total operational expenditure at 0.68 per cent of its total gross income in 2011 as well. Maintaining operational expenditure well-below 1 per cent of the gross income has been a key feature of the Fund over the years.

Table II-5
Operational Expenditure

Item	2010 Rs.mn	2011 Rs.mn	Change (%)
Personnel Expenses	414.3	417.0	0.7
Administrative Expenses	368.1	334.7	(9.1)
Other Expenses	41.6	34.0	(18.3)
Total	824.0	785.7	(4.6)
Total Expenses as a % of Gross Revenue	0.68	0.68	-

Source: EPF Department, Central Bank of Sri Lanka

8.3 Payment of Interest to Members

In 2011, a sum of Rs. 105.2 billion was available for distribution after payment of interest for current year refunds as interest income to the members of the Fund (Table II-6). Accordingly, the Fund was able to pay interest at the rate of 11.5 per cent on member balances (Table II-7) which is a substantially a higher rate of return considering the prevailing interest rate structure in the economy. Interest rate paid on member balances since 2000 is at Table II-7.

Table II-6
Payment of Interest to Members

Item	2010 Rs. mn	2011 Rs. mn	Change (%)
Gross Revenue	121,256	116,043	(4.3)
Total operating expenses	(824)	(786)	(4.6)
Income tax	(8,987)	(8,055)	(10.4)
Brought forward balance of the income statement	18	294	1,553.3
Net income available for distribution	111,463	107,496	(3.6)
Interest paid on current refunds	(1,901)	(2,343)	23.3
Net income available for distribution (after payment of interest on current refunds)	109,562	105,153	(4.0)
Transfers from/(to) reserves	(13,000)	(3,500)	(73.1)
Net income available for distribution after transferring from/(to) reserves	96,562	101,653	5.3
Interest paid on member balances	96,268	101,284	5.2
Carry forward balance	294	369	25.5
Interest rate paid on member balances %	12.50	11.50*	(1.0)

*Provisional

Source: EPF Department,
Central Bank of Sri Lanka

Table II-7
Interest Rate Paid on Member Balances

Year	Interest Rate Paid (%)	Effective Interest Rate (%) ¹
2000	11.50	11.69
2001	11.50	11.69
2002	12.10	12.26
2003	12.00	12.07
2004	9.50	9.59
2005	9.00	9.13
2006	10.10	10.30
2007	11.20	11.40
2008	13.20	13.44
2009	13.75	13.92
2010	12.50	12.65
2011(a)	11.50	12.27

(a) Provisional

Source: EPF Department, Central Bank of Sri Lanka

ER¹ = (Interest Paid to Members) / [(Beginning of the year member balances + Year end member balances)/2]

8.4 Member Account Statements

The member account statements for the first half of 2011 will be issued to members through their employers during March 2012. Arrangements have also been made to issue account statements for the second half of 2011 by end of August 2012.

8.5 Housing Loan Facility

The Housing Loan Scheme which was introduced in 1998 with the objective of facilitating the members to obtain housing loans from the participating lending institutions, viz., Bank of Ceylon, People's Bank, State Mortgage and Investment Bank, HDFC Bank, Co-operative Rural Banks and National Housing Development Authority continued in 2011 as well. EPF continued to issue certificates of guarantees to members as against their EPF balances under this scheme. During the year, 20,041 member balance certificates were issued to participating lending institutions for the approval of housing loans amounting to Rs. 6,355 million (Table II-8). Further, nearly Rs.1,896 million was deducted from relevant member accounts and was remitted to the participating lending institutions in 2011 to settle the loans in arrears during 2010.

Table II-8
Housing Loan Facility

Year	Certificates Issued (No.)	Credit Approved Rs.mn	Amount Remitted to Lending Institutions Rs.mn
2000	12,938	1,648	262
2001	16,066	2,091	381
2002	19,502	2,673	541
2003	18,689	2,792	670
2004	14,307	2,452	735
2005	14,600	2,766	900
2006	15,136	3,049	1,078
2007	12,969	2,872	1,240
2008	12,519	3,008	1,192
2009	10,383	2,680	1,552
2010	13,848	4,512	2,093
2011(a)	20,041	6,355	1,896
Total	180,998	36,898	12,540

(a) Provisional

Source: EPF Department, Central Bank of Sri Lanka

8.6 Public Awareness

Creating public awareness through networking is one of the strategic objectives of the EPF Department. Twelve mobile services were conducted in 2011 with the intention of improving awareness of the EPF members on EPF operations.

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

- (i) Issuing of EPF balance statements to members.
- (ii) Name and National Identity Card (NIC) number Amendments of members.
- (iii) Obtaining of applications from EPF members to

issue NICs by officers of Department of Registration of Persons.

- (iv) Obtaining of applications from EPF members to issue Birth Certificates/ Presumptive Age Certificates by officers of Registrar General's Department.
- (v) Promoting of member registration for SMS and Internet facilities.
- (vi) Counseling of members.

In addition to the above, two awareness programmes were conducted for HR officials of plantation companies. One programme was held at the Ministry of Plantation Industries and the other programme was conducted for the staff of Watawala Plantations Ltd. The department prepared 2 posters on the operations of EPF and distributed to educate the general public.

8.7 Systems Development

With the objective of converging the existing operating system to an automated banking model in the medium-term to enhance efficiency and effectiveness of services to EPF members and the employers, EPF Department with the support of the IT Department of CBSL took several steps to overhaul its IT systems in 2011. The live operations of new ledger system were commenced from January 2011. The new ledger system records all transactions centrally, while facilitating greater integration of the processes in the EPF system at the CBSL, leading to significant improvement in operational efficiency and greater accuracy of data, with minimum manual interventions. Moreover, the new system supports identification of members by the NIC number.

8.8 Re-registration of EPF Members

Re-registration of EPF members is one of the key projects launched jointly by the EPF Department and the Department of Labour to re-register EPF members according to their NICs and assign NIC numbers as the Unique Identification (UID) number which enables both institutions to use a common database for maintenance of the member accounts. Accordingly, EPF database would be transformed into a Member Centric Database (MCD) from Employer Centric database (ECD). This Project is to be implemented in four phases.

- (i) **First phase:** Re-registering of active EPF members (contributing members), has been completed by collecting NIC information of 1.1 million members as at end 2011. Of which, 67 per cent of members were assigned UIDs, while the balance is being processed after further verification from their employers, as there were some issues with data that were provided.
- (ii) **Second phase:** Registering of new EPF members on real time basis under NIC information commenced in November 2010 and was carried out during year 2011 as well. Accordingly, 30,000 new EPF members were registered and updated to the New Member Registry (NMR) during the period. This activity will be continued with a monthly monitoring system to capture NIC information of all new members to

whom member contributions are received by the EPF for the first time in each month.

- (iii) **Third phase:** Linking of multiple member accounts to UIDs commenced in November 2011. This facility provides a value addition for members to access and view their EPF balances of multiple accounts only providing their NIC numbers through Internet and Short Message System (SMS).
- (iv) **Fourth phase:** Re-registering of all the inactive accounts of non-contributing members has been initiated and discussions with the Commissioner of Labour were held in this regard during the latter part of year 2011.

8.9 E-Collection System for EPF Contributions

The EPF Department has introduced a system for employers to submit member contribution details electronically (E-returns) as a replacement for manual payment system (C & C3 returns). Submission of E-returns, a total paperless solution, facilitates minimization of numerous problems currently faced by both the EPF and the employers.

Under this scheme, employers are required to submit only two simple text files monthly in line with the guidelines prepared by the EPF Department to provide the payment details of members. A Direct Debit Payment Scheme has also been introduced for employers enabling the transferring of the monthly contribution directly from their banks to the EPF bank account.

The EPF Department conducted 14 awareness campaigns and workshops under this project for employers during 2011. As a result, registered number of employers with the E-collection system increased to 1,098 in 2011 from 888 in 2010.

The EPF Department has taken another step to obtain services of commercial banks appointing them as collecting agents under this scheme. Accordingly, the Commercial Bank of Ceylon PLC has taken initiative with the EPF to provide the services under their 'Paymaster System' with effect from October 2011. A total of 51 employers are already enjoying the benefit under the Paymaster System during the last two months of 2011. Further, Bank of Ceylon, People's Bank and Hatton National Bank are working towards fulfilling the required IT systems to provide a similar service.

8.10 The Image Scanning Project

With the objective of Moving towards a Near-paperless Operating System, and also to achieve a major medium-term goal for converting EPF into a Banking Model, the Department has identified the importance of electronic storage of documents. Towards this objective, EPF initiated the Image Scanning Project (ISP).

The expected deliverables of the project are as follows:

- (i) Scanning of Form "C", "C3" (Master File Records), Form "D" & Re-registration forms and create an "image archive".

- (ii) Real time scanning of "Form C" and other paper-based records at the point of collection.
- (iii) Establishment of an E-record room replacing the existing Records Management Division.

ISP will enhance the operational efficiency of the Department by minimizing the cost, time, space, human resources and be supportive in achieving the objectives of other on-going projects.

A Tender Board and a Technical Evaluation Committee were established for the procurement of relevant hardware, software and servers required for the above project during 2011. Accordingly, both the Tender Board and the Technical Evaluation Committee are in the process of preparing relevant tender documents to outsource the scanning of documents.

9. EXCHANGE CONTROL

The Exchange Control Department (ECD), continued to discharge responsibilities entrusted to it under the Exchange Control Act. No. 24 of 1953, paying more attention on achieving its goals announced in the Road Map, 2011.

With improved macroeconomic conditions, ECD took steps to further relax exchange control regulations with regard to investment abroad and remove some restrictions imposed on current account transactions.

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

9.1 Issuance of new Directions / Operating Instructions

The ECD issued several new Directions / Operating Instructions to authorized dealers (licensed commercial banks) and other entities dealing in foreign exchange in 2011.

A summary of such Directions/ Operating Instructions is given below. (Details of these Directions / Operating Instructions are given in Part III of the Annual Report).

- (a) **Approval for Service Exporters to Borrow in Foreign Exchange from Domestic Banks:** Authorized dealers were permitted to grant foreign currency loans from the Domestic Banking Unit to meet the fixed and working capital requirements of Exporters of Services who have adequate foreign currency exposure.
- (b) **Outward Investment Account (OIA):** Authorized dealers were permitted to open, maintain and operate accounts titled Outward Investment Account (OIA) in the name of Resident Investors for the purpose of making overseas investments as per the permissions granted by the Minister of Finance and Planning under

the Government Gazette Notification Nos. 1686/50 and 1686/52 dated January 01, 2011 respectively.

- (c) **Authorization of remittances in respect of Re-insurance:** Authorized dealers were permitted to release foreign exchange in respect of reinsurance upon obtaining a confirmation from NITF on the compliance of insurance companies with reinsurance requirement imposed by the Government Gazette Notification No. 1528/20 dated December 19, 2007.
- (d) **Designation of Chinese Renminbi (RMB):** Authorized Dealers were informed decision of the designation of Chinese Renminbi (RMB) for foreign exchange transactions of Licensed Commercial Banks by the Monetary Board of Central Bank of Sri Lanka and permission was also granted to open Non-Resident Foreign Currency (NRFC) Accounts in Chinese Renminbi.
- (e) **Opening of Non – Resident Blocked Accounts:** Permission was granted to authorized dealers to open and maintain "Non-Resident Blocked Account" in the name of non-resident Sri Lankans without references to the Exchange Control Department, to receive local income of such non-residents including the sale proceeds which is derived in Sri Lanka. Further, permission was granted to re-designate the existing rupee accounts of the non-resident Sri Lankans as "Non Resident Blocked Accounts".
- (f) **Resident Non-Nationals' Foreign Currency (RNNFC) Account:** Authorized dealers were permitted to accept the monthly salary and other employments benefits of expatriate employees paid in rupees to the credit of the Resident Non- National Foreign Currency (RNNFC) Account converted into foreign currency and to transfer funds from the accounts of the employers of such expatriate employees at the Off-Shore Banking Units.
- (g) **Securities Investment Accounts (SIA):** The threshold, which permitted for foreign investments in Treasury bills and bonds, was increased from the level of 10 per cent to 12.5 per cent of the outstanding stock of Treasury bills and Treasury bonds.

9.2 Issuance of Government Notifications:

- (a) **Permission to Sri Lankan residents to invest in equity of overseas companies and to acquire sovereign bonds issued by foreign governments (Gazette No. 1686/50 dated 01st January 2011):** Considering the improved macroeconomic environment of the country, residents were permitted to invest in equity of overseas companies and to acquire sovereign bonds issued by foreign governments. It is also expected that these measures will help to integrate domestic investors with international capital markets and improve governance practices and risk management capabilities of domestic entities as well.

Permission was also granted by the Controller of Exchange under Section 7 of the Exchange Control Act to make payments in respect of said investments.

- (b) **Permission to make payments in respect of setting up of places of business outside Sri Lanka (Gazette No. 1686/52 dated 01st January 2011):** The Controller of Exchange granted permission under Section 7 read with Section 3 of the Exchange Control Act, to any company registered under Companies Act No. 7 of 2007 or any partnership registered in Sri Lanka to make payments to persons resident outside Sri Lanka for the purpose of setting up and maintaining any branch, liaison, marketing, agency, project, representative or other similar offices outside the country.
- (c) **Permission to issue of units in a Unit Trust to foreigners (Gazette No. 1719/22 dated 18th August 2011):** The Controller of Exchange granted permission under the Exchange Control Act, for the issue and transfer of units in a Unit Trust operated on a licence issued under the Securities and Exchange Commission of Sri Lanka Act, No. 36 of 1987, as amended, to foreign institutional investors, corporate bodies incorporated outside Sri Lanka and individuals resident outside Sri Lanka and for making any payment to or for the credit of a person resident outside Sri Lanka in respect of the said issue or transfers of units.
- (d) **Permission to borrow for educational purposes from institutions in foreign countries and to repay such loans (Gazette No. 1719/23 dated 18th August 2011):** General permission was granted to Sri Lankan Citizens who have proceeded outside Sri Lanka for educational purposes to borrow from banks, financial institutions, universities or educational institutions in foreign countries and to repay such loans by remitting funds from Sri Lanka through authorized dealers.
- (e) **Permission to make payments to non-resident Sri Lankans by persons in Sri Lanka in respect of purchase of real estate properties of such non-resident Sri Lankans in Sri Lanka (Gazette No. 1719/24 dated 18th August 2011):** General permission was granted to persons in Sri Lanka for making payments in Sri Lanka Rupees to or for the credit of non-resident Sri Lankans as consideration for the purchase of real estate properties in Sri Lanka owned by such non-resident Sri Lankans.
- (f) **Amendments to the permission to foreigners to invest in Rupee Denominated Debentures issued by local companies (Gazette No. 1733/19 dated 22nd November 2011):** The period of redemption or conversion of Debentures was reduced from 5 years to 2 years, and the requirement of maintenance of a sinking fund and the upper limit on interest payment were removed, encouraging more foreign investments in debentures.

- (g) **Permission for the foreigners to invest in companies engaged in the business of a margin provider (Gazette No. 1737/9 dated 20th December 2011):** General permission applicable for the foreign investments in shares of local companies was amended allowing the foreign investments in the local companies carrying on the business of providing margins to investors having registered under the Section 19 (A) of Securities and Exchange Commission of Sri Lanka Act No.36 of 1981.

9.3 Approval for Investment Abroad and Foreign Borrowing:

The ECD processed 93 requests for approval of investments abroad and borrowings from abroad and granted approvals for 47 requests in terms of the relevant provisions of the Exchange Control Act. Approvals were granted for 17 resident companies to invest abroad amounting to US\$ 113.43 million, mainly in the areas of investment banking, trading, retail operations, hotels and resorts, power generation and employee share option schemes. A total of 30 resident companies were permitted to borrow from abroad a sum of US\$ 212.07 million. Meanwhile, resident investors have remitted out a sum of US\$ 0.45 million through the Outward Investment Accounts for the purpose of foreign investments.

9.4 Investigations into Violations of the Provisions of the Exchange Control Act

With a view to deter wrongdoing and malpractices of the participants in the foreign exchange market and ensure the compliance with exchange control regulations, 71 investigations were conducted during the year 2011. A sum of Rs. 25,031,236.69 was collected as the penalties on such violations.

Apart from the imposition of penalties, warning letters and directions were issued to dealers in foreign exchange in connection with their non-compliance with exchange control regulations revealed by the onsite supervisions conducted by the department.

Most of the concluded and pending investigations are related to unauthorized payments by residents to non-residents, violations of the conditions of the permits by restricted dealers in foreign exchange and issue and transfer of securities contravening the procedure set out in the general permissions granted by the Controller of Exchange. Moreover, legal opinions on the exchange control regulations and assistance to conduct investigations were provided with the Police Department in order to raise awareness of the law enforcement authorities on exchange control regulations.

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

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

- (a) As a measure of further liberalization of Exchange Control regulations, permission was granted to Registered Finance Companies (RFC's), Specialized Leasing Establishments (SLE's), Licensed Specialized Banks (LSB's) and selected supermarkets to conduct money changing business. Accordingly, new money changing licences were issued to 8 RFC, 1 SLE, 1 LSB and 2 supermarkets. Further, 11 Limited Liability Companies who fulfilled the existing eligibility criteria were permitted to engage in money changing business. Accordingly, altogether 23 new money changing licences were issued during the year 2011 bringing the total number of money changers to 82. Six money changers who were successful in purchasing foreign currency over US Dollars four million per annum were granted the permission to sell foreign currency.
- (b) 84 new companies were registered as freight forwarders, bringing the total number of freight forwarders to 429 at the end of 2011.
- (c) 46 new permits were issued to other restricted dealers, such as duty free shops, tourists' hotels/restaurants, gem and jewellery shops and travel agents in 2011. However, 30 permits were withdrawn due to their failure to comply with the terms and conditions of the permit and their secession from business, bringing the total number of such restricted dealers to 802.

9.6 Other activities

In continuation of efforts to promote worker remittances through the banking channels, a programme was conducted to encourage Authorized Dealers to formulate more convenient, efficient and less expensive mechanism for this purpose. Public awareness was enhanced on the relaxation of Exchange Control regulations. Authorized Dealers were also educated on such policy measures.

10. FINANCIAL INTELLIGENCE UNIT

In terms of the Financial Transactions Reporting Act (FTRA), No. 6 of 2006, the Financial Intelligence Unit (FIU) carried out its main functions that include collection and receipt of information on financial transactions for the purpose of detecting possible links to Money Laundering (ML), Terrorist Financing (TF) and other unlawful activities, investigations into suspicious financial transactions and dissemination of information and details of investigations to relevant regulatory and law enforcement authorities. The highlights of main functions of the FIU during 2011 are as follows.

Collection of Information and Investigations

Licensed Commercial Banks (LCBs), Licensed Specialised Banks (LSBs), Registered Finance Companies (RFCs), Stock Brokering Firms (SBs) and Insurance Companies (ICs) continued to report to the FIU on cash transactions and electronic funds transfers (both local and foreign) of Rs. 1.0 million and above or its equivalent in foreign currencies through the FIU's on-line database management system, "LankaFIN". Accordingly, over 3.4 million of cash/fund

transfers and 539 suspicious transaction reports (STRs) were reported during the year 2011. After conducting preliminary investigations, 65 STRs were referred to the law enforcement agencies and regulatory authorities for further investigation. Based on the investigations conducted by the Criminal Investigations Department (CID), the Attorney General's Department has filed three indictments against money laundering offences and three indictments against terrorist financing offences as at 31.12.2011.

Improvement in the Regulatory Framework

With the view to further strengthening the regulatory framework in line with the changes in international standards and best practices on Anti-Money Laundering (AML) and Countering the Financing of Terrorism (CFT), the FIU with the support of law making authorities arranged enactments of two Amendment Acts ; Prevention of Money Laundering Amendment Act No. 40 of 2011 and Convention on the Suppression of Terrorist Financing Amendment Act No. 41 of 2011 passed by the Parliament effective from 6th October 2011. The improvement on the legal framework is as follows:

Convention on the Suppression of Terrorist Financing Amendment Act No. 41 of 2011:

- Applicability of terrorist financing law is widened by including citizens of Sri Lanka and non-citizens while present in Sri Lanka.
- The "Funds" is defined to include "assets of every kind whether it is tangible or intangible: movable or immovable" kept in Sri Lanka or outside Sri Lanka.
- Purview of the terrorist financing offence is widened to include financing of a terrorist (single terrorist) and / or for any terrorist act.
- Authority for police to freeze / suspend terrorist funds and properties relating to terrorist financing or activities before indictment.

Prevention of Money Laundering Amendment Act No. 40 of 2011:

- Applicability of the law has been expanded to cover any person who has committed a Money Laundering offence while in Sri Lanka.
- Recovery of corresponding value of the properties related to a Money Laundering offence in the absence of properties derived/realized through Money Laundering.
- Coverage of unlawful activities relating to Money Laundering has been further expanded by lowering the punishment threshold from 7 years to 5 years.
- Foreign predicate offences are introduced as unlawful activities.

These amendments were aimed at improving the legal and regulatory system to combat money laundering and terrorist financing more effectively, keeping with the international standards recommended by Financial Action Task Force (FATF), the global AML/CFT standards and policy setter. Further, the FIU was in the process of finalizing the amendments to Financial Transaction Reporting Act, No. 6 of 2006 to strengthen the operations of the FIU.

The FIU also gazetted rules issued to financial institutions (LCBs and RFCs) in relation to Know-Your-Customer and Customer-Due-Diligence (KYC/CDD) requirements on 28th March 2011.

Other Activities

i. Signing of Memorandums of Understanding:

As a mechanism to facilitate sharing of information and intelligence for the purpose of investigation and prosecution of suspicious transactions, the FIU signed four Memorandums of Understanding (MOUs) with Financial Transactions and Reports Analysis Centre of Canada, The Office for Money Laundering Prevention (OMLP) Slovenia, The Financial Intelligence Units of Fiji and South Africa. Accordingly, the total number of MOUs signed increased to 16 as at end of 2011.

ii. Institutional Capacity Building and Awareness Programmes:

In continued efforts to enhance the awareness on detecting, analyzing and reporting of money laundering and terrorist financing transactions, 28 awareness/training programmes were conducted during the year, accommodating more than 2,300 participants from LCBs, LSBs, RFCs, Police Department, educational and public institutions. Five such programmes were conducted with the assistance from the AUSTRAC; Australian FIU. Further, the FIU conducted two special programmes for judges in collaboration with High Court Judges' Association.

iii. International Relations:

- a). Egmont Group : The FIU obtained assistance from members of the Egmont Group (Association of the FIUs) to carry out investigations and collaborated with the member countries gathering evidence on their investigations. Total number of such instances that FIU exchanged information with foreign counterparty was recorded as 29 for the year 2011.
- b). Asia Pacific Group on Money Laundering: Sri Lanka, as a founder member of Asia Pacific Group on Money Laundering (APG), attended its 14th Annual Meeting held in India in June 2011 and the 14th Annual Typologies Workshop held in South Korea.

iv. Examinations

During the year 2011, FIU conducted four examinations of reporting institutions to assess their exposure to risk of ML and TF and non-compliances with the provision of FTRA and other rules and directions issued by the FIU.

11. FINANCIAL STABILITY STUDIES

The Financial System Stability Department (FSSD) was established in 2007 to assist the Central Bank of Sri Lanka (CBSL) in maintaining the financial system stability, which is one of the core objectives of the CBSL. The department

was renamed the 'Financial Stability Studies Department' (FSSD) with effect from 15th November 2011, in order to refocus its objectives towards financial stability related studies and research. The main functions of the FSSD include conduct of macro-prudential surveillance, the preparation of the Financial System Stability Review (FSSR) and the facilitation of the meetings and functioning of the Financial System Stability Committee (FSSC) and the Financial System Stability Consultative Committee (FSSCC). A brief description of the main activities undertaken by the FSSD in 2011 is given below.

11.1 Macro-prudential surveillance

- a) The FSSD conducts macro-prudential surveillance to identify systemic risks to the financial sector and to assess its capacity to withstand such threats. This involves the analysis of global and domestic macroeconomic and financial market developments and the risk exposures of banking sector, other financial institutions and non-financial institutions. A comprehensive set of aggregate Financial Soundness Indicators is compiled on a periodic basis to monitor the health of key financial and non-financial institutions. The FSSD prepared regular Financial Sector Risk Assessment Reports for the FSSC.
- b) The FSSD computed a Financial Stress Indicator for Sri Lanka which is a composite indicator of the current level of stress in the various financial markets and the banking sector. The Financial Stress Indicator is compiled on a monthly basis.
- c) The FSSD also compiles the quarterly Banking Soundness Index which is an aggregate indicator of the soundness and stability of the banking sector. The FSSD also conducts stress tests based on the banking sector, based on sensitivity analysis on a quarterly basis, to ascertain the resilience of the sector to different types of risks such as credit risk, market risk and liquidity risk shocks. The FSSD has also initiated macro-financial stress tests by developing a credit risk model which examines the impact of certain macroeconomic variables on the asset quality of the banking sector.
- d) The FSSD also constructed a Corporate Sector Credit Worthiness Indicator to analyze the credit worthiness of the corporate sector in Sri Lanka by assessing the probability of default of companies listed on the Colombo Stock Exchange. Financial indicators representing profitability and leverage are the independent variables in the model.

11.2 Publications

The Financial System Stability Review (FSSR) 2010 was published in January 2011. The FSSR 2011 was prepared in the last quarter of 2011 and will be published in the first quarter of 2012. The FSSR 2011 containing six chapters and seven box articles provides an overall risk and stability assessment of the financial system, as well as an account of the major global and domestic macroeconomic and

financial market developments, the performance of the banking sector and other financial institutions and risks, the functioning of the key payment and settlements systems and the regulatory framework governing the financial sector. The FSSD also coordinated the preparation of the chapter on 'Financial Sector Performance and System Stability' in the Annual Report 2010 and chapter on 'Financial Sector Developments and Stability' in the Recent Economic Developments 2011.

11.3 Coordination of the Committees on Financial System Stability.

FSSD continued to serve as the secretariat for the FSSC and FSSCC in 2011.

- a) The FSSC is chaired by the Deputy Governor in charge of financial system stability and is composed of departmental heads involved in the financial stability activities. The FSSC has been an inter-departmental forum for the identification of risks affecting the financial sector, discussion of measures to mitigate risks and the co-ordination of efforts to promote financial system stability. The FSSC had eight meetings during 2011.
- b) The FSSCC which was appointed by the Monetary Board, consists of persons primarily from the private sector to provide views and advice to the CBSL on financial sector issues. The current FSSCC comprises of ten members and had ten meetings during the year.

12. GOVERNOR'S SECRETARIAT

The Governor's Secretariat Department (GSD) performed its tasks during the year by providing extensive operational and technical assistance required by the Governor in order to carry out the mission of the Central Bank. Accordingly, the GSD mainly engaged in providing high level secretarial, administrative assistance and protocol services throughout the year.

Scheduling of the Governor's appointments, together with proper coordination with the parties involved, was carried out smoothly and as in the previous year, the GSD arranged a large number of meetings for the Governor. Such meetings included meetings with high level Government officials, Chief Executive Officers and others of banks and financial institutions, business community leaders, delegations from IMF, World Bank, foreign investors, etc. All such appointments, correspondence regarding the meetings and follow-up work were coordinated with relevant parties thereby assuring proper time management for the Governor. The GSD also extended secretarial assistance to the Governor by drafting and processing necessary documents including presentations, speeches, keynote addresses, notes, correspondence, etc.

At the same time, the GSD handled with high courtesy, a large number of incoming and outgoing telephone calls for the Governor. The GSD assisted the public on a daily basis by responding promptly to their queries directed to the Governor, with regard to the activities of the Bank

and other issues relating to the economy of Sri Lanka. In addition, the GSD handled incoming and outgoing postal mails, e-mails and other correspondence and presented such information in a suitably summarized form to the Governor. Also, the GSD acted as a coordinator in providing necessary data, information and any other inputs for the Governor and ensured the provision of data on operations of money and foreign exchange markets, and other important information in real time to the Governor, particularly when the Governor was overseas, so as to enable the Governor to take the necessary decisions.

The GSD worked in close cooperation with the senior management and all other departments of the Bank and relevant outside institutions, and closely followed up the instructions issued by the Governor to ensure that the entrusted tasks were carried out in time. Moreover, during the year, the GSD had regular interactions with foreign investors and provided them with timely information and clarifications on various matters pertaining to the Sri Lankan economy. The Governor attended a number of press conferences and participated at local and foreign media interviews, for which the GSD provided the necessary logistical support and arrangements. The GSD also actively participated in organizing events for the 60th Anniversary celebrations of the Central Bank, and during the year, the GSD organized and coordinated many meetings for events of national interest as well.

The GSD provided necessary protocol services for the Governor, Deputy Governors, VIP visitors to the Governor and VIP invitees to the Bank. All arrangements for local and foreign travel of the Governor were made by the GSD. The Governor made several field visits to a number of places of economic significance and attended many branch openings of banks and other financial institutions, particularly in the Northern Province, for which the necessary arrangements together with other protocol services were arranged. In addition, the Governor attended a number of symposiums held in Sri Lanka for which events too, the necessary protocol services were provided.

The Governor also made a number of official visits abroad to attend high-level international symposiums, investor meetings and other official meetings, in addition to participating at state visits. In this regard, while providing the logistics for the Governor's foreign travel, the GSD also facilitated by providing necessary information, reports and presentations in order to ensure the success of these events. The logistics for official foreign travel of Deputy Governors were arranged by the GSD while all official functions hosted by Governor and Deputy Governors were arranged by the GSD.

13. HUMAN RESOURCES MANAGEMENT

As in the past, the Human Resources Department (HRD) continued its effort in 2011 to further improve the quality and productivity of the human capital of the Bank through the provision of opportunities for higher education and

encouraging learning for self-development. The key functions performed in this regard included training and development, motivation, performance management, job rotation, succession planning and maintaining closer dialogue with all stakeholders of the Bank in line with the human resources needs identified in the Strategic Plan of the Bank.

13.1 Human Resources Structure

As at the end of December 2011, the total staff strength of the Bank stood at 1,441 consisting of 629 staff class

officers, 646 non-staff class officers, 162 minor employees and 04 officers who are providing their services under fixed term contracts. The average age of an employee in the Bank as at December 31, 2011 was 41 years. Out of the total number of staff class officers, nearly 83 per cent had a first degree qualification, postgraduate degree or an accepted professional qualification. During the year 2011, 23 staff class officers, 17 non-staff class officers and 2 minor employees retired, while 10 employees resigned from the Bank service.

Table II – 9
Human Resources Structure as at 31.12.2011

Categories of Employees	No. of Employees			Average Age (Years)	Educational/Professional Qualifications					
	Male	Female	Total		Post Graduate, First Degree & Professional Qualifications	Post Graduate & First Degree	Post Graduate & Professional Qualifications	First Degree & Professional Qualifications	First Degree	Professional Qualification
(1) Staff Class										
(i) Grade IV and above	57	19	76	52	14	50	03	04	05	0
(ii) Grade III	61	20	81	51	05	38	01	02	32	0
(iii) Grade II	86	87	173	43	09	23	03	32	78	05
(iv) Grade I	111	188	299	40	04	13	01	42	133	23
(2) Non-Staff Class										
(i) Grade V	30	45	75	55	0	0	0	0	20	02
(ii) Grade IV	89	40	129	49	0	0	0	0	11	01
(iii) Grade III	55	12	67	52	0	0	01	0	01	02
(iv) Grade II	104	79	183	33	0	0	0	01	13	04
(v) Grade I	96	06	102	45	0	0	0	0	0	0
(vi) BAA	38	52	90	24	0	0	0	01	12	04
(3) Minor Employee Class										
(i) Grade I, II and III	149	13	162	31	0	0	0	0	0	0
(4) Officers who are providing their service under fixed term contract										
(i) All Categories	03	01	04	51	0	02	0	0	0	01
Total	879	562	1441	41	32	126	09	82	305	42

13.2 Recruitment

Considering the necessity for acquiring specialised professional talents for the Corporate Support Services sector in the Bank, an Electrical Engineer was recruited in 2011 under the lateral recruitment policy of the Bank. In 2011, HRD took measures to outsource the services of a Medical Officer and a Medical Nurse for the Medical Centre and an Instructor for the Gymnasium of the Bank. In addition, HRD also took measures to provide services of a Litho Machine

Operator and a Type Setter/Page Designer (Sinhala) for the Communications Department and services of some categories of staff for the Security Services Department and Restaurant of the Bank on outsourced basis.

HRD also facilitated in recruitment of employees for the Poverty Alleviation Microfinance Project (PAMP) II steered by the Regional Development Department of the Bank. Accordingly, in 2011, HRD supported for selecting the suitable employees for the posts of Project Regional Manager, Regional Credit

Coordinator cum Monitoring Coordinator, Regional Training Coordinator, Regional Marketing Coordinator, Accountant, IT cum Monitoring & Evaluation Officer, Junior Executive, Typist, Data Entry Operator and Driver for the PAMP II project.

13.3 Performance Management System

With the objective of improving efficiency and productivity of the staff, the Bank annually conducts an evaluation system for managing performance of its staff. Under this system, the level of performance of each individual employee is evaluated, taking into consideration the employee's contribution for achieving the overall vision and mission of the Bank. At the beginning of each year, the performance evaluation process commences with setting of goals and assigning with appropriate weights, in line with the Strategic Plan of the relevant departments and in consultation with the relevant supervisors. At the end of each year, the employees complete the self-evaluation section of the performance evaluation form giving a performance rating for each goal. Subsequently, a discussion is held between the employee and the supervisor to arrive at the final performance rating. In addition, each employee submits his/her learning, training and career development plans along with the performance evaluation form to the supervisor for assessment. The final performance ratings are used as one criterion for granting promotions.

Accordingly, the evaluation of performance of all employees for the year 2010 was completed as scheduled in HR Strategic Plan 2011 -2015. At the beginning of 2011, the individual and departmental goal setting process for the year 2011 was also completed as per the time targets set out in the Strategic Plan.

13.4 Promotions

HRD took measures to fill the vacancies in all key positions of the Bank and grant class and grade promotions for the employees who became eligible in 2011 to receive their promotions. Accordingly, three Assistant Governors were promoted to the posts of Deputy Governors and seventeen Deputy Heads of Department to the posts of Heads/Additional Heads of Department. During the year, one Staff Class Grade III officer was promoted to the post of Deputy Head of Department, while eleven Personal Assistants in Non-Staff Class Grade IV and V were promoted to Staff Class Grade I as Personal Secretaries. During the year, a total of 85 staff members were granted their grade promotions.

13.5 Training and development

Recognizing the importance of training in achieving higher performance in day to day banking activities, HRD continued to facilitate staff training and development through providing opportunities for its staff to participate in training programmes, workshops, seminars and part time courses offered by both local and overseas training institutions. In 2011 HRD provided 2,048 foreign and local training opportunities covering the areas of economics, financial system stability, risk management,

bank supervision, reserves management and human resources management as compared with the 1,641 training opportunities provided in 2010.

The number of officers who participated in foreign and local training amounted to 204 and 1,844 respectively in 2011.

(a) Foreign training

The number of foreign training opportunities provided in 2011 increased by 7 per cent to 204 as compared with 190 foreign training opportunities provided in 2010. These officers undertook studies in a wide range of subject areas in various training programmes, seminars, workshops and conferences conducted by reputed training institutions abroad.

With the intention of ensuring effective utilization of knowledge gained through training programmes, the participants of these programmes were requested to undertake special assignments to initiate new activities or improve existing activities based on the knowledge gained by attending such training programmes. The Training Sub-Committee, appointed for this purpose conducted 19 pre and post training discussions with the officers who attended foreign training programmes in 2011.

Table II -10

Short-Term Foreign Training Opportunities – 2011

Field	No. of Participants
Economics and Economic Policies	43
Financial System and Regulation	29
Risk Management	49
Finance	17
IT and Payment System	14
Public Debt Management	5
Central Banking	11
Human Resource Management	7
Other	29
Total	204

(b) Post-graduate studies

In addition to the strategic focus on developing staff through local and foreign training programmes, the Bank continued its scholarship programme aiming at strengthening intellectual capacity of the staff of the Bank. In 2011, 17 officers commenced Master's degree programmes, while 3 officers commenced Ph.D programmes at recognised universities in the UK, USA and Australia. In 2011, 8 officers resumed duty after completion of Master's degree programmes and 2 officers resumed duty after completion of the Ph.D programmes.

(c) Local training

The number of local training opportunities provided in

2011 increased by 27 per cent to 1,844 as compared with 1,451 training opportunities provided in 2010. The majority of these officers participated in training programmes conducted by the Center for Banking Studies (CBS). The number of officers who participated in the training programmes conducted by CBS and other recognized local training institutions were 1,380 and 464, respectively. In providing local training, priority was given to train officers in the fields of Information and Communication Technology, Financial and Capital Markets, Bank Supervision, Macro Economic Analysis, Internal Auditing and General Management etc.

HRD also organised 8 managerial workshops in 2011, specially aiming at enhancing leadership skills, motivation, positive thinking, teamwork and report writing skills of the Bank staff, ranging from staff class officers to minor employees.

In line with the measures taken by the Government for effective implementation of Official Languages Policy in 2007 to enhance the productivity in the Public Service, the Bank continued providing Tamil Language programmes in 2011 as well with the intention of enhancing the language proficiency in Tamil of the Bank staff.

13.6 Job rotation

With the objective of developing a multi-skilled work force and enhancing overall productivity of the Bank, HRD annually implements a job rotation scheme. Under this scheme, the employees who have served for more than five years in one department are eligible for rotation. In 2011, considering the competency requirements of the various departments and the competency levels of the employees who were eligible for rotation, HRD rotated 53 staff members among 18 departments and 3 provincial offices of the Bank.

13.7 Employer- employee Relations

HRD continued to facilitate maintaining a closer dialogue between the Trade Unions and the Management in 2011. Arrangements were made for the Trade Unions to meet the Management to discuss issues as and when necessary and accordingly 6 discussions were held during the year. Such dialogues facilitated for the Management to resolve a number of issues relating to recruitment, promotions, training, welfare and general administration of the Bank and no industrial disputes occurred during the year 2011.

Meetings Attended by the Governor

1. Enterprising India 2011 Investors' Conference in February.
2. Meetings with Government officials, European Institute for Asian Studies, and meetings with investors in Belgium in March.
3. Meeting with the Governor, Bank of England, media interviews and Commonwealth Games Federation Convention in UK in April.
4. 2018 Bid Lodgment Ceremony of the Commonwealth

Games Federation and visiting the SEACEN Centre in Malaysia in May.

5. Meetings with investors in UK, Asian Clearing Union Board of Governors' Meeting and SAARC Governors' Symposium in India and St Petersburg International Economic Forum in Russia in June.
6. Meetings with regard to the International Sovereign Bond Issue in Singapore, Hong Kong, UK & USA in July.
7. Confederation of Asian and Pacific Accountants (CAPA) Conference as the keynote speaker in Australia and 66th Session of the UN General Assembly as a member of the Sri Lankan delegation in USA in September.
8. UN ESCAP's G20 High-Level Consultation Summit and chairing the Session on "Sustaining Growth and Developments amid Global Uncertainties" in Thailand, meetings with investors in Malaysia, meetings with Business and Political Leaders in New Zealand, Commonwealth Heads of Government Meeting (CHOGM) as a member of the Sri Lankan delegation, Commonwealth Business Forum, and CHOGM Sports Breakfast in Australia and meeting with the Monetary Authority of Brunei in October.
9. Commonwealth Games Federation General Assembly and addressing the Eastern Caribbean Central Bank in St Kitts & Nevis, delivering the keynote address at the 5th SEACEN Advanced Leadership Course and the keynote address at the Invest Sri Lanka Investment Forum in Malaysia, 40th Anniversary celebrations of the Monetary Authority of Singapore and delivering the keynote address at Invest Sri Lanka Investment Forum in Singapore in November.
10. Delivering the keynote address at the UNESCAP's Meeting on "Macroeconomic Policy, Poverty Reduction and Inclusive Development" in Thailand and 4th Bali Democracy Forum in Indonesia in December.

PROMOTIONS/APPOINTMENTS

1. The following promotions and appointments were made effective during the year 2011.
 - I. Mr. B. D. W. A. Silva was appointed as Deputy Governor with effect from 27 September 2011.
 - II. Dr. P. N. Weerasinghe was appointed as Deputy Governor with effect from 27 September 2011.
 - III. Mrs. C. Premaratne was appointed as Deputy Governor with effect from 01 January 2012.
 - IV. Mr. T.W. Ariyaratne was promoted to Staff Class Grade IV and appointed as Acting Additional Director of the Welfare Department with effect from 13 June 2011.
 - V. Mr. V. Baskaran was promoted to Staff Class Grade IV and appointed as Acting Additional Director of the Regional Development Department with effect from 13 June 2011.

- VI. Miss S.H. Gunawardena was promoted to Staff Class Grade IV and appointed as Acting Additional Superintendent of the Currency Department with effect from 13 June 2011.
- VII. Mr. S.J. Hapuarachchi was promoted to Staff Class Grade IV and appointed as Acting Additional Controller of the Exchange Control Department with effect from 13 June 2011.
- VIII. Dr.(Mrs.) Y.M. Indraratne was promoted to Staff Class Grade IV and appointed as Acting Additional Director of the Economic Research Department with effect from 13 June 2011.
- IX. Mr. R.R. Jayaratna was promoted to Staff Class Grade IV and appointed as Acting Additional Controller of the Exchange Control Department with effect from 13 June 2011.
- X. Mr. B. W. Jinasena was promoted to Staff Class Grade IV and appointed as Acting Additional Secretary of the Secretariat Department with effect from 13 June 2011.
- XI. Mr. D. Kumaratunge was promoted to Staff Class Grade IV and appointed as Acting Additional Director of the Economic Research Department with effect from 13 June 2011.
- XII. Mrs. U.L. Muthugala was promoted to Staff Class Grade IV and appointed as Acting Additional Director of the International Operations Department with effect from 13 June 2011.
- XIII. Mr. M. L. M. Nizar was promoted to Staff Class Grade IV and appointed as Acting Additional Director of the Information Technology Department with effect from 13 June 2011.
- XIV. Mr. P.L.S.K. Perera was promoted to Staff Class Grade IV and appointed as Acting Additional Controller of the Exchange Control Department with effect from 13 June 2011.
- XV. Mr. L.D.D.Y. Perera was promoted to Staff Class Grade IV and appointed as Acting Additional Superintendent of the Employee's Provident Fund Department with effect from 13 June 2011.
- XVI. Mr. A.J.L. Peiris was promoted to Staff Class Grade IV and appointed as Acting Additional Director of the Payments and Settlements Department with effect from 13 June 2011.
- XVII. Mr. S.K. Ranasinghe was promoted to Staff Class Grade IV and appointed as Acting Additional Director of the Financial Intelligence Unit with effect from 13 June 2011.
- XVIII. Mr. H.P.G.S. Ratnasiri was promoted to Staff Class Grade IV and appointed as Acting Additional Director of the Financial Stability Studies Department with effect from 13 June 2011.
- XIX. Mr. T.H.B. Sarathchandra was promoted to Staff Class Grade IV and appointed as Acting Additional Superintendent of the Public Debt Department with effect from 13 June 2011. Subsequently, he was appointed as the Acting Additional Director of the Statistics Department with effect from 15 November 2011.
- XX. Mr. H. Sriyaratne was promoted to Staff Class Grade IV and appointed as Acting Additional Director of the Premises Department with effect from 13 June 2011.
2. Mr. A.M.R.K. Attanayake, Additional Controller of the Exchange Control Department, was appointed as Additional Director of the Regional Development Department with effect from 03 January 2011.
3. Mr. J.P.R. Karunaratne, Additional Director of the Department of Supervision of Non-Bank Financial Institutions, was appointed as Additional Superintendent of the Public Debt Department with effect from 09 May 2011.
4. Mr. S.M.A. Siriwardane, Additional Director of the Provincial Offices Monitoring Department, was appointed as Acting Director of the Provincial Offices Monitoring Department with effect from 04 October 2011.
5. Mr. D. Wasantha, Director of the Statistics Department, was appointed as Director of the Policy Review and Monitoring Department with effect from 02 November 2011.
6. Mr. M.J.S. Abeysinghe, Director of the Policy Review and Monitoring Department, was appointed as Director of the Regional Development Department with effect from 02 November 2011.
7. Mr. E.A. Hettiarachchi, Director of the Regional Development Department, was appointed as Director of the Statistics Department with effect from 02 November 2011.
8. Mr. H. Amaratunga, Additional Director of the Management Audit Department, was appointed as Additional Director of the Provincial Offices Monitoring Department with effect from 02 November 2011.
9. Mr. K.P.N.S. Karunagoda, Additional Director of the Welfare Department, was appointed as Acting Director of the Welfare Department with effect from 07 December 2011.

RETIREMENTS

1. Mr. P.D.J. Fernando, Deputy Governor, retired from the Bank service with effect from 27 September 2011.
2. Mr. K.G.D.D. Dheerasinghe, Deputy Governor, retired from the Bank service with effect from 15 December 2011.
3. Mr. Y.A. De Silva, Assistant Governor, retired from the Bank service with effect from 28 September 2011.

4. Mr. F.C.S. Mendis, Director of the Provincial Offices Monitoring Department, retired from the Bank service with effect from 04 October 2011.
5. Mrs. S.N. Perera, Director of the Welfare Department, retired from the Bank service with effect from 07 December 2011.
6. Mr. K.L.L. Fernando, Additional Director of the Premises Department, retired from the Bank service with effect from 11 December 2011.
7. Mr. P.L.S.K. Perera, Acting Additional Controller of the Exchange Control Department, retired from the Bank service with effect from 07 November 2011.
8. Mr. S.J. Hapuarachchi, Acting Additional Controller of the Exchange Control Department, retired from the Bank service with effect from 28 December 2011.

OFFICERS ON RELEASE

1. Dr. P.N. Weerasinghe, Deputy Governor, to the International Monetary Fund as an Alternate Executive Director.
2. Mr. S.R. Attygalle, Staff Class Grade IV officer, to the Ministry of Finance and Planning.
3. Mr. K.M.M. Siriwardena, Staff Class Grade IV officer, to the Ministry of Finance and Planning.
4. Mr. C.N. Wijayasekera, Staff Class Grade IV officer, to the Ministry of Finance and Planning.
5. Mr. U.V. Perera, Staff Class Grade II officer, to the Ministry of Finance and Planning.
6. Mr. M. Mahinda Saliya, Staff Class Grade II officer, to the Ministry of Finance and Planning.
7. Mrs. H.P.A. Priyashanthi, Staff Class Grade II officer, to the Ministry of Finance and Planning.
8. Mr. N.D.Y.C. Weerasinghe, Staff Class Grade II officer, to the Ministry of Finance and Planning.
9. Mr. D.M. Wanninayake, Staff Class Grade II officer, to the Ministry of Defence and Urban Development.
10. Mr. W.H.M. Kumara, Staff Class Grade II officer, to the Ministry of Defence and Urban Development.
11. Mr. H.M.N. Dharshana, Staff Class Grade II officer, to the Ministry of Defence and Urban Development.
12. Mr. J.A.A. Priyantha, Staff Class Grade I officer, to the Presidential Secretariat.
13. Mrs. A.C. Abeyasinghe, Staff Class Grade I officer, to the International Monetary Fund.
14. Mrs. H.M.N.S. Gunawardena, Legal officer (on contract), to the Ministry of Finance and Planning.

14. INFORMATION TECHNOLOGY

The Information Technology Department (ITD) by performing its role as a strategic business enabler providing integrated and innovative technology solutions

attended to enhance the operational excellence to ensure achieving core objectives of the CBSL. During the year, the ITD accomplished its role in achieving goals in four major areas, i.e. (a) developing new business projects (b) enhancing existing business projects (c) maintaining operational excellence and (d) providing value-added IT services, the details of which are described below :

(a) Developing New Business Projects

The ITD strived to develop state of the art IT solutions to cater to diverse business needs of the CBSL to align with its theme for 2011, 'Repositioning for the new era'. The following are the major business solutions developed by the ITD to cater to the needs of the clusters of the CBSL.

- An Integrated Human Resource Management System (eHRNet) for effective human resource management through information backed decision making. This will be a shared information base for all HR related applications.
- Automated solution for Deposit Insurance Scheme (DIS) which is a safety net facilitating overall financial system stability of the country. This system facilitates Bank Supervision Department to handle financial accounting in compliance with International Financial Reporting Standards (IFRS) and fund investments.
- An Activity Based Costing System for Finance Department to effectively capture and divide the cost of the top management among the relevant functionalities of the departments.
- A software solution for Welfare Department to electronically maintain medical records of the employees and to manage an inventory of drugs.
- A comprehensive Inventory Management Solution (e-Store) for Secretariat Department providing facilities to electronically handle request for administrative store items with proper internal controls.
- An IT solution for Currency Department to record and monitor the counterfeiting activities of currency notes reported by legal authorities which provided for graphical interpretation of information relating to counterfeiting activities.
- An EPF re-engineering process paving the way for greater integration among sub-systems, increasing efficiency of processing of refunds and making a conducive environment for EPF fund investment. Acting as a change agent, ITD closely monitored performance of operations of the project, conducted user awareness sessions and completed required system modifications to ensure smooth functionality in new computing environment.

(b) Enhancing Existing Business Projects

The ITD supported enhancements of existing business projects for pro-active and continuous improvements of efficiency and effectiveness of business delivery, supporting the following projects during 2011.

- Extending the Central Database System (FinNet) to collect periodic regulatory information from specialized leasing companies. Under this, certain financial returns that were submitted by LCBs and RFCs were modified in compliance with IFRS. Modified system would greatly help in effectively carrying out the off-site surveillance functions of the CBSL.
- Extending the facilities provided through International Operations Management System (IOMS) to accommodate petroleum import bills, loans and their settlements and to maintain the Domestic Foreign Currency Account.
- Modifying the existing ForexNet system that is used by Exchange Control Department to enhance the monitoring of forex sales, purchases, investments, foreign exchange transactions relating to migrant allowances and Outward Investment Account (OIA).

(c) Maintaining Operational Excellence

The ITD, ensuring its commitment to improve the operational delivery of the CBSL, engaged in uplifting the performance of applications and services.

In order to handle anticipated increase in volume of transactions, hardware used for LankaSettle System was replaced ensuring a more robust, efficient and reliable national payment and settlement system to strengthen the financial system stability. Agreements of LankaSettle System and General Ledger System between the CBSL and vendors were renewed for a further extended future period with favourable terms. A procedure to upgrade the existing general ledger system was also planned to avoid technology obsolescence and to meet evolving user requirements.

A collaborative software solution was purchased based on tender procedures to introduce user friendly and feature rich environment for electronic messaging, document management, IT asset management and backup management system ensuring the efficient use of IT resources of the CBSL.

The ITD co-ordinated and supervised the installation of a local area network at LLOYDS building linking it to the Head Office using a dedicated leased line connection to ensure continuity of EPF operations at the LLOYDS building. A secure Virtual Private Network (VPN) connection between the LankaClear (Pvt) Ltd and the CBSL was established to ensure on-line transfer of clearing balances to be settled through LankaSettle system.

Bandwidth of main Internet Leased Line was upgraded from 10Mbps to 14Mbps through mutual agreement with service provider without incurring any additional cost. This would facilitate to meet enhanced demand for research and development of the CBSL while providing improved access to web applications deployed for statutory purposes.

With a view to providing uninterrupted IT support services, IT Help Desk services were maintained for extended hours from 0700h to 2000h during working days. All existing IT systems which were developed in-house were maintained fully, while ensuring maintenance support for procured IT systems in compliance with the terms of the service agreements.

The ITD was able to achieve over 99.86% system availability of Systemically Important Payment and Settlement Systems (SIPSS) during the year and to maintain 100% operational availability of the rest of the IT systems which were in operation.

(d) Providing Value-added IT Services

Focusing on the importance of maintaining strategic partnership between the CBSL and Financial industry, the ITD prepared technological guidelines for mobile payments to ensure safety in mobile transactions. The Internet Banking Guidelines were drafted to maintain transaction security in internet enabled products to the customers. Action was taken to set up a Computer Security Incident Response Team for Financial Sector (BankCSIRT) as a risk mitigation measure.

The ITD provided technical advisory services to Lanka Financial Services Bureau and local SWIFT user group to migrate SWIFT Alliance Access software from the existing Version 6 to Version 7. In supporting the achievement of major milestones of the National Payment Council, ITD provided technical expertise to LankaClear (Pvt) Limited to implement a Common Cards and Payments Switch which would function as a national switch for all local credit, debit and ATM card based transactions.

Recognising the importance of Business Continuity Planning (BCP), the BCP of the CBSL was reviewed and updated regularly while participating at BCP drills during the year from the Disaster Recovery Site (DRS) with the participation of the CBSL staff and external financial institutions namely, licensed commercial banks, primary dealers and Lankaclear (Pvt) limited.

ITD provided technical expertise to review the operational reliability of DRS locations of LankaSettle participants to mitigate operational risks of SIPSS and assisted newly established LCBs to ensure smooth operations with the CBSL.

During the year, the ITD facilitated internal and external information system audits to assess any vulnerability in the internal controls of IT solutions deployed at the CBSL.

15. INTERNATIONAL OPERATIONS

The International Operations Department (IOD) is entrusted to perform the management of the international reserves of the Central Bank. During the year 2011, IOD managed its international reserves in a prudent manner and achieved a remarkably high rate of return whilst ensuring its safety and liquidity amid protracted global credit crisis. The IOD which is also responsible for monitoring the domestic foreign exchange market took appropriate measures to ensure its smooth operations during the year under review.

15.1 International Reserves Management

The persistent international financial crisis posed many challenges in global reserve management. The lingering European debt crisis that spilled over to the entire globe and the US debt ceiling during the year under review resulted in significant volatility in major currencies and bond yields. In addition to the financial turmoil, the year 2011 was another year of natural disasters and political chaos spreading across the globe, which included the Australian floods, Japan's Tsunami and unrest in the Middle East, that contributed towards the uncertainties in the financial markets. Under these circumstances, CBSL had to perform a challenging task in managing its international reserves prudently while maximizing the returns and minimizing the risk involved. The timely actions taken, prudent risk management and the appropriate diversification techniques adopted by IOD assisted in preserving the reserve portfolio of CBSL.

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

The Bank's overall reserve management operations have generated a net foreign income of US\$ 430 million (approximately Rs.48 billion) during the year 2011. In the midst of comparatively low interest market environment,

progress was made under challenging circumstances in generating a significant income through foreign currency trading with the maximum use of the market fluctuations and capital gains derived on fixed income securities. In addition, remarkable return on gold trading due to significant price volatility in the global commodity market contributed the most towards the increase in the total return.

In view of the expanding reserves, it was decided to enhance the operations of IOD by expanding the scope and extent of the foreign reserves management activities. This entailed an increase in the staff allocation, modernization of physical infrastructure, multiple shift working arrangements and changes in the investment horizon. Accordingly, during the year under review IOD extended its working hours from 7.00 am to 10.00 pm to cover the different time horizons with the increased number of dealers, diversified its investments into the Asia Pacific region such as Chinese offshore bond market with a close scrutiny on risk-reward analysis. These activities are expected to assist the effective management of the foreign reserves in a highly volatile and indecisive global market conditions.

15.2 Risk Management

The Middle Office of IOD engaged in monitoring and measuring the risks associated with the investment of international reserves continuously during the year under review. Foreign exchange markets experience price and volume fluctuations due to dynamic forces of demand and supply of foreign currency assets. Therefore, there is a need to evaluate both the risk consequences and measuring the performance of trading. The investments of international reserves were exposed to various categories of risks, of which exchange rate risk, interest rate risk, credit risk, liquidity risk and operational risks were considered as major components.

- The CBSL managed the exchange rate risk or the currency risk effectively with portfolio diversification and appropriate currency combinations strategically set, focusing on the impending foreign currency liabilities and by analysing the global outlook of currency market movements including trade patterns. Value at risk (VaR) is one of the important measures used by CBSL for risk appraisal of the foreign reserves portfolio and it indicates that there is a high probability that the value of the Fixed Income Securities portfolio would not significantly deplete in the short run. IOD also uses tools such as stop loss orders to manage foreign exchange risks and losses during trading.
- Interest rate risk was mitigated successfully by varying the durations of the fixed income and money market investments and timely shifting of the portfolio among different maturities. Sensitivity analysis is also carried out to quantify the interest rate risk in order to gauge the risk exposure and timely action was taken to mitigate the risk.

- Counterparty Credit Risk Management System (CCRMS), which is an internally developed system that facilitates a comprehensive evaluation of the counterparties based on financial indicators, credit ratings and their market exposures, was used by IOD to manage the counterparty credit risk. Eurozone debt crisis had direct negative impact on counterparties and a number of mitigating measures were taken by IOD to minimize the impact on trading.
- The liquidity risk was effectively managed by forecasting cash flows and analyzing maturity profile of assets and liabilities while maintaining a sufficient proportion of assets in respective currencies in liquid form including highly marketable securities. Accordingly, all the payments were carried out on timely basis without any default during the period under review.
- The operational risk arising from the people, systems and processes were managed through measures such as strengthening of the verification process, improvements to the trading system and updating of the investment guidelines. Monitoring of adherence to the operational guidelines were strictly followed and IOD tested its disaster recovery contingency plan successfully during the year without any failures.

15.3 Domestic Foreign Exchange Market Developments

IOD continued to participate in the activities of the domestic foreign exchange market and also conducted close monitoring of the market mainly the foreign exchange transactions and overnight net foreign exchange positions of commercial banks during the year 2011, with a view to promoting the smooth functioning of the domestic foreign exchange market and to ensure an orderly adjustment of the exchange rate of the domestic currency.

The Sri Lanka rupee appreciated marginally against the US dollar during the first ten months of the year 2011. The foreign exchange inflows during this period were mainly from IMF Standby agreement, foreign investments, sovereign bond issue, private remittances and trade related inflows. However, towards the end of the year, there was pressure for depreciation mainly due to the significant outflows of foreign exchange arising from petroleum, gold and vehicle imports. During the year 2011, CBSL played a vital role in the domestic foreign exchange market in order to curb the excess volatility in the exchange rate of the Sri Lanka rupee. The total amount injected to the domestic foreign exchange market by CBSL in gross terms was US dollars 3,183 million and the amount absorbed was US dollars 343 million resulting in a net sale of US dollars 2,840 million during the year under review.

The Sri Lanka rupee depreciated by 2.59 per cent against the US dollar in 2011. It moved from Sri Lanka rupees 110.95 per US dollar as at end 2010 to Sri Lanka rupees 113.90 per US dollar as at end 2011. The volume of

inter-bank foreign exchange transactions which amounted to US dollars 11.06 billion in 2010 increased significantly to US dollars 16.44 billion in 2011 recording a 49 per cent increase. The process of providing information on exchange rates of Sri Lanka rupees against other currencies to government departments, corporations, local and foreign agencies and other users continued during 2011 as in the previous years.

Table II-11
Inter-Bank Foreign Exchange Transactions
Volume – 2011

(US\$ mn)

Months	Spot	Tom	Cash	Forward	Total
January	477.35	113.85	96.50	459.35	1147.05
February	362.25	71.95	118.05	212.26	764.51
March	658.10	116.10	119.50	416.46	1310.16
April	538.40	135.00	149.20	393.25	1215.85
May	531.55	203.95	206.00	514.93	1456.43
June	573.80	243.95	264.70	694.41	1776.86
July	408.40	211.45	194.80	402.16	1216.81
August	622.33	195.05	226.10	557.35	1600.83
September	652.40	138.85	159.25	445.01	1395.51
October	653.53	145.60	135.20	546.95	1481.28
November	741.15	196.95	134.60	553.95	1626.65
December	702.23	137.29	151.90	459.09	1450.50
Total	6921.48	1909.99	1955.80	5655.16	16442.42

Source: International Operations Department, Central Bank of Sri Lanka

Table II-12
Purchases and Sales of Foreign Exchange by the
Central Bank – 2011

(US\$ mn)

Months	Purchases	Sales	Net
January	30.50	-	30.50
February	-	170.75	(170.75)
March	117.65	7.00	110.65
April	-	127.55	(127.55)
May	-	130.15	(130.15)
June	100.29	7.70	92.59
July	-	416.99	(416.99)
August	-	197.60	(197.60)
September	-	514.05	(514.05)
October	-	431.58	(431.58)
November	30.00	594.15	(564.15)
December	65.00	586.18	(521.18)
Total	343.44	3183.69	(2840.25)

Source: International Operations Department, Central Bank of Sri Lanka

16. MANAGEMENT AUDIT

The Department of Management Audit continued to provide independent objective assurance and advisory services to add value and improve the operations and systems of control of the CBSL during 2011. In this regard, the effectiveness of the risk management, controls and governance processes were evaluated and recommendations were made depending on requirements.

Adherence to globally accepted standards, best practices and the maintenance of the quality of audit activities are important pre-requisites in offering assurance and advisory services. In that regard, the Department continued to implement the audit quality improvement activities, that have been recommended in the external quality assessment report, with the support of a team of professionals whose services were obtained on outsourced basis. On that basis, the Department prepared an Audit Manual, identified the audit universe of the CBSL, and compiled the Bank-wide Risk-based Strategic Audit Plan and Risk-based Annual Operational Audit Plan.

During the year, the audit work documentation process was further refined by introducing a set of new formats including a new audit result communication format. In addition, the audit observations reporting methodology was improved by adopting a four-step reporting process; conduct of a closing conference, written communication of audit observations, issue of a draft report after receiving the responses from the respective departments for the observations communicated and the issue of the final report.

In addition, the Department took action to enhance the competencies of the audit staff during the year. Accordingly, local and foreign training opportunities were provided to the audit staff on auditing, risk management, internal controls, international financial reporting standards, reserve management and liquidity management. In-house presentations on global auditing standards, accounting standards and other related subjects were also conducted for the benefit of the audit staff.

Further, local and foreign training opportunities were provided to the information system audit staff with a view of enhancing their competency levels. Training was also conducted to familiarise staff in the utilization of Audit Command Language in retrieving and analyzing data in performing audits, as well.

While focusing on the improvements to the audit function as explained above, the Department facilitated the Bank to achieve its objectives by providing value added assurance and advisory services on operations and controls. One of the major audits conducted in that regard was the verification of data accuracy of the Net International Reserve and Reserve Money Data reported to the International Monetary Fund. Reviewing of procedures with regard to Counterparty Selection and Management of Credit Risk, Maintenance of Current Accounts of Internal and External Parties, Monitoring of Primary Market Dealers, Staff Identity Card Management System and Fire Security were also

some of the other major audits conducted. Routine audits were conducted covering the activities of the International Operations Department, Payments and Settlements Department, Domestic Operations Department, Public Debt Department and Currency Department.

With the introduction of the Risk-based audit methodology, the information system audit function was also expanded significantly. Accordingly, audits on major systems such as Open Market Operations On-line Electronic Bidding System, Real Time Gross Settlement System, Scripless Securities Settlement System and Treasury Dealing Room Management System were conducted during the year. Fail Over Tests conducted by the Business Continuity Planning Committee were also observed and assessed.

The Department reported the audit observations together with recommendations for improvements to the process owners as and when audits were finalized. The progress of the conduct of audits was reported to the Governor, the Monetary Board Advisory Audit Committee and the Monetary Board at regular intervals and, on half yearly basis, to the Auditor General.

17. PAYMENTS AND SETTLEMENTS

The Payments and Settlements Department (PSD) continued to focus on promoting safe, sound and efficient payment and settlement systems. In discharging its mission in 2011, PSD carried out operations of the Real Time Gross Settlement (RTGS) System, the back-office functions to process and effect payment and settlement instructions in respect of CBSL's foreign exchange reserve management and open market operations, management of the SWIFT communication system, and effecting fund transfers through Asian Clearing Union. The policy formulation and oversight activities were also carried out in order to ensure smooth operations of the payment and settlement systems and to mitigate potential risks that could affect the payment system stability. Further, PSD continued to perform the secretarial work of the SAARC Payments Initiative (SPI) Secretariat of the SAARC Payments Council.

17.1 Operating the Real Time Gross Settlement (RTGS) System

As the operator of the RTGS System, PSD continued to effect settlement of inter-participant payments in financial markets as well as their customer payments on real time gross basis and provided help desk services to participants throughout the operating hours of the system. The total volume of transactions settled by the RTGS System during 2011 was 267,289 with a total value of Rs.57,790 billion. RTGS System recorded its highest volume of 1,515 transactions and value of Rs.490 billion in a day during the year 2011. The average volume and average value of transactions settled per day were 1,114 and Rs.241 billion, respectively. PSD facilitated and monitored the fund releases around Rs.11.6 billion per day to the participants, who requested extra funds to ensure smooth functioning of the system, through Intraday Liquidity Facility (ILF).

Participants in the RTGS System consist of CBSL, 24 LCBs, 7 Non-bank Primary Dealers (PDs), Employees Provident Fund (EPF) and the Central Depository System (CDS) of the Colombo Stock Exchange. During the year, two LCBs viz. Amāna Bank Ltd. and Axis Bank Ltd. and one PD viz. WealthTrust Securities Limited were appointed as members of the system and therefore, the total number of participants increased to 34 as at end 2011. The system availability, which is the performance indicator of the RTGS System, was 99.86% during the year 2011. In order to ensure the readiness of the system to contingency events, a live operation session at Disaster Recovery (DR) site was completed successfully during the year. The maintenance agreement of the LankaSettle System which was signed in 2003 with the vendor, Logica UK, expired in September, 2011. Accordingly, PSD made arrangements to sign a new agreement with the same vendor for five years.

17.2 Settlement of Foreign Exchange Transactions

PSD continued the back-office operations to facilitate the foreign exchange transactions including transactions in gold and fixed income securities originated by International Operations Department (IOD) during 2011. The total volume of forex transactions settled by the back-office increased by 27.5 per cent to 24,263 transactions during the year when compared to 2010. The total value of transactions was USD 214 billion recording a significant increase of 53.4 per cent compared to the previous year.

Due to the increase in both volume and value of transactions in forex, gold and fixed income securities, IOD extended its dealing hours up to 10.00 pm. Consequently, PSD also commenced shift-based working system by extending working hours to 8.00 pm, in the latter part of the year, in order to facilitate a high volume of transactions.

17.3 Settlement of Transactions under Open Market Operations

Back-office functions for the open market operations originated by the Domestic Operations Department were continued by PSD through the allocation of securities in the CBSL portfolio to the LankaSettle participants based on the repo and reverse repo transactions made by them. Accordingly, during the year, PSD effected 7,708 repo transactions amounting to Rs.14,490 billion and 233 reverse repo transactions amounting to Rs.141 billion. PSD continued the provision of Intra-day Liquidity for participants and monitored the settlement of ILF. During the year 2011, Rs. 2,778.5 billion were settled in respect of 10,253 transactions under ILF.

17.4 SWIFT Communication

PSD uses SWIFT System for its operations as well as for operations of the other users of CBSL. To maintain a better connectivity and provide a cost effective service to users, SWIFT-Net direct connectivity of CBSL was changed to an indirect connectivity through Lanka Financial Services Bureau Ltd. in November, 2011.

In line with the high volume of foreign exchange transactions due partly to the shift-based working system of IOD, the SWIFT communications operations also expanded. In 2011, the total number of SWIFT messages sent and received were 1,425,944 and 844,514, respectively. Out of the total messages received, 229,073 messages were for CBSL transactions while the balance was for the RTGS System and securities related transactions.

17.5 Transactions under the Asian Clearing Union (ACU)

PSD facilitated payments for intra-regional transactions of member countries through ACU mechanism. The total value of transactions effected by Sri Lanka through ACU mechanism increased by 58 per cent to Rs. 488.5 billion in 2011. This was mainly due to the increased oil imports from Iran and India. However, the total volume of transactions effected through ACU mechanism increased only by 4 per cent in 2011. Although the number of transactions with Iran and Pakistan recorded a substantial decline, the increased number of transactions with Nepal and India were able to negate this decline. The rupee value of net settlements made under ACU mechanism also increased to Rs. 411.7 billion in 2011 from Rs. 265.2 billion in 2010.

The 40th meeting of the Board of Directors of ACU, which was held in India in June 2011, focused mainly on the recommendations of the ACU Technical Committee, i.e., using web-based application by members for messaging, accounting and reconciliation and applying more practical mechanism to calculate working days excluding holidays in respective member countries for net settlements.

17.6 Payment System Policy and Oversight

The focus of payment system policy and oversight procedures during the year 2011 was directed mainly towards reducing of risks of electronic retail payment systems while continuing standard oversight activities. In terms of the Service Providers of Payment Card Regulations No. 1 of 2009, PSD renewed licences of 17 service providers of payment cards in 2011 and evaluated 2 applications received from service providers interested in providing debit cards to their customers. Further, PSD monitored the activities of credit card issuers for compliance with the conditions set out in the credit card operational guidelines issued in 2010. Self-evaluation reports prepared by credit card issuers as per the credit card operational guideline were evaluated and websites of all credit card issuers were examined to ensure compliance with the web disclosure requirements. In addition, the code of conduct for the credit card issuers, prepared by the Payment Card Industry Association of Sri Lanka, to fulfill a requirement of the guidelines was finalized during the year 2011 and they were directed to adhere to the code of conduct in providing their services to customers.

Considering the importance of having safe and secure payment card operations in the country, the National Payments Council (NPC) recommended the adoption

of line encryption technology by financial acquirers. Accordingly, PSD instructed the acquiring banks to initiate action to incorporate the proposed security feature. As at end 2011, almost all financial acquirers commenced application of the line encryption technology. The implementation of line encryption technology is to be completed during the year 2012.

With a view of facilitating the development of mobile payments systems while promoting safety, efficiency and reliability, PSD issued two Mobile Payment Services Guidelines to regulate the service providers of mobile phone based payment services. The Mobile Payment Guidelines No. 1 of 2011 were issued to streamline the bank-led mobile banking services while the Mobile Payment Guidelines No. 2 of 2011 were issued to streamline the custodian account based mobile banking services. The guidelines mainly focused to address the risks of mobile phone based payment mechanisms, such as anonymity (difficult to know the customer when a payment is effected), elusiveness (ability to disguise mobile transactions totals, origins and destination), rapidity (speed with which illicit transaction can occur), remoteness and wide spread of the agents involved in the business.

In order to ensure the smooth operations of the upgraded Sri Lanka Interbank Payment System (SLIPS) operated by LankaClear(Pvt) Ltd., PSD issued the General Direction No.1 of 2011 for SLIPS operations in 2011. Further, having considered the systemic and settlement risk of effecting high value payments through the Cheque Imaging and Truncation (CIT) system, PSD initiated action to reduce routing of such cheques through the CIT system. As the high value cheques were issued mostly by the government departments, the Ministry of Finance was requested to initiate action to direct relevant institutions to use electronic large value payment methods when effecting such high value payments.

The participants of the LankaSettle System were encouraged to conduct live test runs from their DR sites during 2010 and 2011. Based on the results of the test runs, recommendations were made to the respective participants for further improvements in their contingency arrangements. In addition, two new LCBs and one PD began operations during the year 2011 and their BCPs and DR sites were also evaluated before granting participant status in the LankaSettle System and recommendations were given for further improvements.

During the year 2011, PSD continued to publish the quarterly Payments Bulletin in the CBSL website for dissemination of information on payment and settlement systems in the country. Further, a brochure on using the credit card wisely was prepared and distributed to educate cardholders and prospective cardholders. In addition, PSD conducted awareness programmes to educate the general public and the banking community on payment systems and other related issues.

17.7 SAARC Payments Initiative (SPI) and SAARC Payments Council (SPC)

On behalf of the member countries, PSD carried out the functions of the SAARC Payments Initiative Secretariat in 2011 for the third consecutive year. The website of the SPI was maintained and updated with the information on the progress of the SPC and SPI. Further, 6th and 7th volumes of the SAARC Payments Bulletins were published during the year 2011. PSD facilitated to organize the 9th SPC meeting in Maldives in May, 2011 and the 10th meeting of the SPC was held in Sri Lanka in November, 2011.

Considering the improvements made by member countries in high value payment systems and institutional arrangements on payment and settlement systems since its inception in 2008, SPC diverted its focus in 2010 to the development of electronic retail payment systems and identifying risks and measures to be adopted to minimize such risks. Accordingly, the objectives of the SPC were revised and finalized at the 10th meeting, based on the new vision and mission statements finalized by the SPC members at the 9th meeting.

18. POLICY REVIEW AND MONITORING

The Policy Review & Monitoring Department (PRMD) is entrusted with the responsibility of conducting policy reviews and studies, coordinating the preparation of Strategic Plan of the CBSL, and monitoring the progress of the implementation of the Strategic Plan. The department also continued to update and save, in electronic form, all policy related documents issued during the period.

(a) Conducting Policy Reviews

During the year, PRMD completed two studies, i.e., a case study on the resolution of crisis in the banking sector and a study on efficiency of disbursement of housing loan under the Central Bank Staff Housing Loan Scheme. Based on these, two presentations were made to the management with recommendations. A study on increasing trend of currency in circulation and a case study on the resolution of the crisis in non-bank financial sector were in progress. On-line e-policy and procedure library was updated regularly with policy related documents such as directions, guidelines and publications issued by the departments of the Central Bank. A proposal was submitted to ITD to upgrade e-policy and procedure library with a view to improving its user friendliness.

(b) Implementing Strategic Plan 2011-2015

Continuing with the strategic planning process, which was started in 2007, the 5th Strategic Plan of the CBSL for 2011 – 2015, carrying the theme of “Repositioning for the New Era”, was successfully implemented during 2011. In order to educate the staff of the CBSL on their respective roles and responsibilities in ensuring the effective implementation of the Strategic Plan 2011 - 2015, a two day workshop was conducted for all staff members of the CBSL during the first week of

January 2011. As a part of the workshop, which was held under a cluster basis, a survey was conducted during the workshop and the survey results indicated that staff of the Bank possessed a satisfactory level of awareness on the main elements of the strategic planning process.

The CBSL recorded an average achievement rate of more than 93 per cent of the work assigned to its departments and provincial offices, in 2011. PRMD conducted quarterly progress review meetings with each department and provincial office to assess the level of their achievement under the Strategic Plan 2011-2015 and to identify issues that hinder the successful implementation of the Strategic Plan. Outcomes of the review meetings were reported to the Strategic Plan Review Committee (SPRC), which is chaired by the Governor and comprise of the corporate management of the CBSL. Based on the report, remedial actions were taken by the management to deal with issues and bottlenecks identified during the progress review. The decisions of the SPRC were communicated to respective departments and provincial offices and necessary follow up actions were taken.

(c) Coordinating the Strategic Planning Process

PRMD organized a three day strategic planning retreat under the theme of **"Raising the Bar"** during the period from 30th September to 2nd October 2011 at Earl's Regency, Kandy with the participation of corporate management of the bank, heads of department and their representatives. This theme was selected to highlight the need for continuous improvement in productivity, efficiency and quality of the services of the CBSL in marching towards doubling our per capita income by 2016 and also to bring the service norms in line with best international standards in discharging our statutory mandate. The purpose of this 6th consecutive retreat was to review the progress of achievement under the current Strategic Plan and update it on a rolling five year period for 2012-2016, with a view to raising the productivity and efficiency of operations of the CBSL in order to face challenges from the external front and also to cater to new growth trajectory envisaged. Prior to the retreat, PRMD conducted pre-retreat meetings with all the departments and provincial offices of the CBSL to ensure that the selected theme is adequately reflected in the departmental Strategic Plans.

19. PREMISES

During the year, 2011, the Premises Department (PRD) ensured operational reliability of critical services and a pleasing and comfortable working environment for the staff to work towards achieving the objectives of the Central Bank. Also, the Department transformed its scope of work from traditional activities to facilities management.

In line with the Strategic Plan in 2011, PRD continued to carry out its primary functions aiming to achieve its goals including the maintenance and up-keeping of the Bank's premises and maintenance of a high degree of operational reliability of all critical services such as supplying of the logistical facilities, electricity, air-conditioning, water supply, transport and communication. The Department was able to achieve almost 100 per cent reliability in providing those facilities contributing to ensure business continuity of the Bank.

The refurbishment work of the Lloyd's Building which yields a substantial enhancement of the value of the properties of the Central Bank of Sri Lanka (CBSL), was completed in May, 2011, and it was declared open to house the Employees' Provident Fund Department. Restoring the appearance of this historic building to its original glory with high standards of construction quality was an outcome of the collective efforts of the professional staff of PRD and the outsourced contractors/consultants, and guidance of the senior management. In addition, refurbishment of the Central Point Building formerly named as National Mutual Assurance Building, which is a 100 years old colonial building situated in front of the CBSL Building and acquired by the CBSL, was also commenced in 2011.

The PRD was able to successfully complete the conversion of the Conference Hall at Level 14 of the CBSL Building into a modern Multimedia and Audio Visual Conference Hall introducing audio compatible interior designs. The modern technological improvements and equipment were installed to enhance the quality, elevating its position to a high standard conference hall. The Atrium of CBSL was also modernized and enhanced the outlook and its environment with high tech instruments.

The refurbishment works and upgrading of facilities of Holiday Homes at Kataragama and Nuwara Eliya were completed in 2011. The renovation of the 25 years old Auditorium of the North Central Provincial Office to give a modern outlook with enhanced technological improvements was almost completed. In order to expand the ongoing development activities undertaken by the Eastern Provincial Office of CBSL and to provide more logistic facilities to the general public, PRD played a major role in providing a more spacious premises in Trincomalee. The electrical and maintenance work of the Centre for Banking Studies (CBS) at Rajagiriya, were attended timely and in order to ensure uninterrupted power supply a 400 KVA new generator was installed at CBS. Necessary arrangements were made to construct a new car park adjoining the CBSL Head Office Building, with the plan to commence the construction work during the first quarter of 2012.

In 2011, PRD strengthened its fleet of vehicles by purchasing new vehicles and improving the conditions of the vehicles to mitigate operational risk. The Department was able to provide uninterrupted transport facilities for a number of international conferences sponsored by CBSL, in addition to the transport facilities to normal functions

of the Bank. Further, facilities were provided for religious functions, and events with national interest.

Further, PRD continued cordial and effective relationship with the external parties which provided services to CBSL.

20. PROVINCIAL OFFICES MONITORING

The Provincial Offices Monitoring Department (POMD), expanded its activities during 2011, with the close monitoring of 5 Provincial Offices (POs) located at Matara, Anuradhapura, Matale, Jaffna and Trincomalee.

(a) Monitoring the Functions of the Provincial Offices (POs)

The POMD, continued with on-site and off-site monitoring of the POs to ensure that the activities of the POs are carried out in line with their strategic goals. During the year 2011, 6 meetings were conducted with the Provincial Managers while 20 inspection visits were made by the POMD staff to the provinces. The POMD also reviewed the performance of POs based on the information collected from them through weekly and monthly returns. Certain functions that are being carried out by the other Departments of the CBSL in the provinces were further delegated to the POs in 2011. Attention was also paid to streamline the activities of POs by getting them more involved in the expansion of the functions of the Central Bank during 2012. In this regard, a workshop was conducted for the staff of the POs in December 2011 in order to educate them in conducting awareness programmes in the provinces, on behalf of the other Departments of the CBSL.

b). Activities of the Provincial Offices

i) Development activities

The main focus of all the POs in 2011 was to extend the major functions of the Central Bank at provincial level. Accordingly, all five POs were extensively engaged in promoting

economically viable investments in the respective provinces, through credit schemes such as New Comprehensive Rural Credit Scheme, Agro-Livestock Development Loan Scheme, Self Employment Promotion Initiative Loan Scheme, Saubhagya Loan Scheme and Poverty Alleviation Micro Finance Project (PAMP II) operated by the RDD. Meanwhile, the Provincial Office-Northern Province and the Provincial Office-Eastern Province established in the year 2010, showed a remarkable progress during the year 2011, particularly, in promoting banking activities and reviving small and medium scale enterprises in the region.

ii) Awareness programmes and skills development programmes

The POs conducted 798 awareness programmes and 124 skills development programmes for 30,006 and 5,662 participants, respectively, during the year 2011. Awareness programmes were conducted to educate the general public and other interested parties on CBSL credit schemes, Forward Sales Contracts, and on different banking/finance related topics such as investment in Government Securities, promotion of savings habits, identification of forged currency notes and good habits of using currency notes and consequences of investing in unauthorized finance companies. The skills development programmes conducted by the POs covered subject areas such as scientific farming practices, post-harvest techniques, high-tech agriculture, home gardening, mushroom cultivation, coir based products, bee keeping, horticulture etc. These programmes were conducted in association with the relevant institutions in the provinces.

The details of programmes conducted by the POs during 2011 are given in the table II-13.

Table II-13
Programmes Conducted by the Provincial Offices during 2011

Provincial Office	Awareness Programmes		Skills Development Programmes	
	No. of Programmes	No. of Participants	No. of Programmes	No. of Participants
Southern Province	154	5,113	24	1,355
North-Central Province	109	4,477	32	1,767
Central Province	205	6,734	39	1,294
Northern Province	159	7,135	15	563
Eastern Province	171	6,547	14	683
Total	798	30,006	124	5,662

c) Other Activities

The POs assisted other Departments of the CBSL by deploying the staff attached to them for activities such as conducting surveys, organizing seminars, workshops and exhibitions at the provincial level. The POs also attended to a large number of member inquiries on the Employees' Provident Fund and involved in selling publications and commemorative coins issued by the Central Bank. Further, the employees of POs have represented the Central Bank at various meetings held in the provinces particularly on matters relating to regional development during the year 2011.

21. PUBLIC DEBT

The Central Bank of Sri Lanka, as the fiscal agent of the government, is responsible for the management of public debt. Accordingly, the Public Debt Department (PDD) continued to engage in activities relating to the issuance, servicing and management of domestic debt and servicing of foreign debt on behalf of the government. This entailed the issue and service of a variety of government securities namely, Treasury bills (T-bills), Treasury bonds (T-bonds), Rupee loans and US dollar denominated Sri Lanka Development Bonds (SLDBs) and Sovereign Bonds at the lowest possible costs and also enhancing the investor confidence in government debt instruments. The total debt stock managed by the PDD amounted to Rs. 5,134 billion by end 2011 comprising Rs. 2,804 billion of domestic debt and Rs. 2,330 billion of foreign debt.

PDD took several measures in 2011 to ensure efficient and effective management of public debt within the public debt management strategy approved by the Monetary Board in line with the borrowing requirement of the government as stipulated in the 2011 budget. The key objectives of such measures were reduction of maturity mismatch in the domestic debt portfolio, lowering of the share of short-term domestic debt to total domestic debt, reduction of the share of foreign currency debt to total debt, extending the yield curve by issuing long-term government securities as benchmarks, improving the country's sovereign rating in line with the 'Medium Term Sovereign Rating Strategy' of achieving an 'Investment Grade' of BBB- or higher by end 2014. Accordingly, PDD continued to engage in issuing domestic and foreign debt instruments effectively while managing the underlying risks of the debt stock at prudent levels, timely servicing of domestic and external debts, broadening and diversification of investor base, improving the regulatory framework for PDs, timely recording of government securities in the Central Depository System (CDS). A summary of performance of PDD in 2011 is given below.

(a) Borrowing Targets and Strategy

As per the Budget 2011, the total gross borrowing limit of the government for 2011, net of contingency provisions, amounted to Rs. 997 billion (book value) showing an increase of Rs. 17 billion compared to 2010. Of this, Rs. 338.9 billion was expected to be

raised from the foreign sources and the balance Rs. 658.1 billion from the domestic sources. However, in line with the medium term public debt management strategy, to reduce the share of foreign currency debt to total debt, borrowing from foreign sources was reduced to Rs. 322.8 billion, while funds mobilized from the domestic sources was increased to Rs. 671.3 billion. The total gross borrowing (Rs. 994.1 billion) was maintained within the borrowing limit for the year 2011.

In December 2011, the maximum limit allowed for foreign investors to invest in T-bills and T-bonds was increased from 10 per cent to 12.5 per cent of the total outstanding amount of both instruments. The limit was increased to meet the growing demand from foreign investors in the government securities, with the increased foreign investor confidence in the domestic markets. As a result, the outstanding foreign investments in rupee denominated government securities (T-bills and T-bonds) amounted to Rs. 269.6 billion (face value) as at end 2011 recording an increase of Rs. 28.7 billion or 12 per cent during the year.

In view of the improved investor confidence and government's intervention to build up a benchmark yield curve for sovereign bonds, the fourth International Sovereign Bond of US dollar 1 billion, with a maturity period of 10 years, was launched in July, 2011. Part of the sovereign bond proceeds was used to restructure the government debt stock by way of early retirement of high cost borrowings of Rupee Loans amounting to Rs. 20.3 billion which had been borrowed at an interest rate of 18.6 to 19.0 per cent. The other foreign borrowings, including funds mobilized through concessional loans amounted to Rs. 177.8 billion in 2011.

In order to address the problem of bunching of T-bills and T-bonds maturities that would lead to high roll-over risk, measures were taken in 2011 to replace maturing short-term T-bonds with medium to long-term maturities. Accordingly, issue of T-bonds with maturity period less than 2 years were reduced to 12 per cent of the total T-bond issues in 2011 from 25 per cent in 2010 and the share of T-bonds issued in the year with maturities over 6 years increased significantly to 43 per cent from 17 per cent in 2010.

In line with the medium-term debt management targets, the Debt to Gross Domestic Product (GDP) ratio further decreased to 78.5 per cent of GDP in 2011 in comparison to 81.9 per cent at end 2010, reflecting favourable debt dynamics in 2011. Other key debt indicators also showed significant improvements in 2011 compared to the previous year. The ratio of short-term domestic currency debt to total domestic currency debt increased from 26.4 per cent at end 2010 to 28.0 per cent at end 2011 while the average time to maturity (ATM) of domestic debt increased from 2.10 years in 2010 to 2.35 years

in 2011 due to the issuance of 8 new Treasury bond series with maturity ranging from 2 to 15 years.

(b) Issuance of Debt Instruments

In line with the market conditions, PDD used a combination of various debt instruments to raise Rs. 994.1 billion, the gross borrowing requirement of the government, in 2011. As in the previous years, the T-bills and T-bonds were the key instruments used for raising the funds and issuances were made through both auctions and direct placements.

T-bills amounting to Rs. 1,165 billion (face value) were issued during 2011. Of this total, Rs. 1,075 billion was re-issues, while the balance Rs. 89 billion was new issues. There were 52 weekly T-bill auctions during the year through which Rs. 489 billion was mobilized and the balance Rs. 676 billion was raised through direct placements at the weighted average yield rates of the latest primary auction. The net foreign participation in the T-bills stood at Rs. 70 billion at the end of 2011 in comparison to the Rs. 17 billion at the end of 2010.

During 2011, Rs. 603 billion (face value) was raised from the issuances of T-bonds through primary auctions and direct placements. With the strong demand for Treasury bonds by foreign investors, the net foreign participation in Treasury bonds increased to Rs. 199 billion in 2011 compared to Rs. 38 billion in 2010.

The total amount of funds mobilized through the auctions and direct placements of SLDBs amounted to US dollar 547 million. These SLDBs were issued with maturities ranging from 3 – 5 years at interest rates of six month LIBOR plus a spread ranging from 365 bps to 390 bps.

Considering the existing favourable debt dynamics together with other positive macroeconomic developments, three credit rating agencies upgraded the country's sovereign rating in June 2011 after their annual sovereign credit rating reviews. Accordingly, Standard & Poor's raised Sri Lanka foreign currency rating to B+ with outlook 'Positive', Fitch Ratings affirmed BB- rating and raised outlook to 'Stable'. Moody's Investor assigned B1 rating and raised outlook to 'Positive'. In order to benefit from the improved investor confidence as well as the low interest that prevailed in international markets, the fourth Sovereign Bond for US dollars 1,000 million with a ten year maturity was launched in July 2011. Despite the unfavourable global financial market conditions, the offering attracted an order book of US dollars 7.5 billion bids, thereby being oversubscribed. The issue was priced at a fixed rate yield of 6.25 per cent, equivalent to a spread of 332 bps over the 10 year US Treasuries.

(c) Debt Service Payments

PDD continued to maintain the country's unblemished record in debt servicing by ensuring accuracy in debt service payments in terms of counterparty, amount, and timing. In 2011, PDD paid Rs. 895 billion as debt services payments. This included payment of Rs. 538 billion on account of principal repayment of debts and payment of Rs. 357 billion on account of interest. Debt service payments made in 2011 relating to domestic debts and external debts amounted to Rs. 728 billion and Rs. 167 billion, respectively.

(d) Benchmark Yield Rates

Given the monetary policy stance of the Central Bank and also improved macroeconomic environment, primary market weighted average yield rates for 91-day, 182-day, and 364-day T-bills which were at 7.24 per cent, 7.33 per cent and 7.55 per cent, respectively, at the beginning of the year, fell to 7.15 per cent, 7.23 per cent and 7.31 per cent, respectively, at end of September 2011. However, from the beginning of the fourth quarter of 2011, primary market yield rates started to move up mainly due to rapid decline in rupee liquidity in the market. The benchmark yield rates on T-bills primary auctions for 91-day, 182-day and 364-day increased by 153 bps to 8.68 per cent, by 148 bps to 8.71 per cent and by 200 bps to 9.31 per cent, respectively, by end December 2011. Despite the upward pressure on benchmark yield rates on T-bills towards the latter part of 2011, the annualized weighted average yield rate (AWAYR) on T-bills fell by 101 bps to 7.31 per cent in 2011 in comparison to 8.32 per cent in 2010. The weighted average yield rates by maturity and the AWAYR for the period from 2008 to 2011 are given in the Table II-14 below:

Table II-14
Weighted Average Yield Rates of Treasury Bills - 2008-2011

Year	Maturity			Annualised overall Avg.
	91-days	181-days	364-days	
2008	18.54	18.45	18.89	18.59
2009	11.43	12.18	12.76	12.25
2010	7.86	8.42	8.43	8.32
2011	7.28	7.21	7.41	7.31

Source: Central Bank of Sri Lanka

Taking the advantage of declined yield rates during the first nine months of 2011, PDD was able to extend the yield curve up to 15 years along with the issuance of a 15-year T-bond at a yield of 9.30 per cent per annum.

(e) Performance of LankaSecure: The Scripless Securities Settlement System (SSSS) and the Central Depository System (CDS)

PDD continued to enhance the efficiency and effectiveness of government securities market by ensuring smooth functioning of the Scripless Securities Settlement System (SSSS) and the Central Depository System (CDS) called LankaSecure during 2011. The number of participants in the LankaSecure, increased from 30 in 2010 to 33 in 2011 with the addition of two new LCBS, Amana Bank Limited and Axis Bank Limited, and a new non-bank PD, Wealthtrust Securities Limited. The number of accounts maintained at CDS too increased by 3.9 per cent from 73,396 in 2010 to 76,286 in 2011. The LankaSecure continued to issue Monthly Transaction Summaries, Transaction-wise Payment Statements, and Semi-annual Statements of Holdings to the investors in government securities. The total value of Scripless securities recorded in the LankaSecure increased by 12 per cent to Rs. 2,684 billion in 2011.

(f) Supervision of Primary Dealers

PDD continued to carry out supervision on activities of PDs through off-site surveillance and risk based on-site examinations in 2011. The off-site surveillance is an ongoing monitoring mechanism on the affairs of individual PDs based on a number of periodic returns submitted to the Superintendent of Public Debt (SPD). The off-site surveillance on PDs continued to serve as an early warning system on possible adverse development in connection with the solvency, liquidity and profitability of individual PDs as well as the Primary Dealer Industry that need prompt corrective action, including further examination or restrictions on certain activities of respective PDs. Analysis of returns submitted by individual PDs on their market and liquidity risk exposures and making specific corrective measures, follow-up actions on corrective measures recommended in on-site examination reports and meetings with senior management of PDs were made in facilitation of off-site supervision on PDs. The on-site examination on activities of PDs involves the assessment of the exposure to various risks, including market, liquidity, operational, legal and reputational risks, assessment of the adequacy and effectiveness of the institutional framework for the management of such risks and adequacy of resources i.e. earnings, capital and management to mitigate the risk exposures of PDs. PDD conducted 8 on-site examinations and one spot examination in 2011 and time-bound corrective measures were taken to rectify the regulatory concerns.

(g) Government Securities Market Development

PDD conducted 17 investor awareness programmes covering 6 provinces, including the Northern Province, and participated in 2 exhibitions during the year. Such awareness programmes helped popularizing government debt securities among the general public and broadening the investor base in 2011.

PDD has initiated measures to put in place an e-trading platform for government securities with a view to introduce an automatic price discovery mechanism to stimulate the government securities secondary market activities. Necessary approvals to implement e-trading system together with required training were provided to most PDs in 2011.

22. REGIONAL DEVELOPMENT

In 2011, Regional Development Department (RDD) aimed at promoting regional development by coordinating, facilitating and implementing cost effective credit schemes and other credit supplementary services for needy people in the agriculture, livestock and micro, small and medium scale enterprise (MSME) sectors through Participating Financial Institutions (PFIs). These credit programmes and other credit supplementary services were funded by Government of Sri Lanka (GOSL), donor agencies, PFIs and Central Bank of Sri Lanka (CBSL). The strategic objectives of the credit delivery programmes implemented by the RDD are as follows.

- a. Enhancement of regional growth through ensuring availability of credit and other services in the regions.
- b. Reduction of poverty by promoting financial inclusiveness among the low income people in the regions.
- c. Creation of income generating activities and employment opportunities among unemployed, educated youth, women and self employed by facilitating them to obtain finance from the formal financial sector and to acquire required knowledge and technical skills through capacity building programmes.
- d. Resumption of business and economic activities in the regions that were affected by the conflict and natural disasters.
- e. Enhancement of production of essential food items to ensure food security for the people.

During 2011, RDD implemented several loan schemes as given in Table II-15 by providing refinance or interest subsidies along with credit supplementary services to PFIs.

Table II-15

Regional Development Lending Programmes Implemented by the Regional Development Department.

	Name of the Project	Source of Funds	Broad Mission	Fund Allocation (Rs. Mn)	Funds Disbursed in 2011 (Rs. Mn)	Annual Interest Rate to Borrowers
1	Agriculture and Animal Husbandry Sector					
1.1	Second Perennial Crops Development Project - Revolving Fund (SPCDP-RF)	GOSL	Commercialisation of Perennial Crop Sector, increasing production, nursery development, post-harvest handling and processing activities and marketing.	1,200	110	9%
1.2	Tea Development Project - Revolving Fund (TDP-RF)	GOSL	Increasing tea small holders' income on a sustainable basis and developing the necessary infrastructure to meet the requirements of the export market by modernising tea factories to acquire HACCP certification.	1,100	7	9%
1.3	New Comprehensive Rural Credit Scheme (NCRCS)	PFI's own funds and Government interest subsidy	Uplifting the socioeconomic conditions of micro and small scale farmers who engage in cultivation of paddy and short term crops.	Depends on the demand for funds	6,419	8%
1.4	"Viskam" Credit Line for Development of Commercialised Agribusiness	CBSL	Development of commercial agribusiness through diversification and making other improvements in the agribusiness activities.	1,100	356	8%
1.5	Agro Livestock Development Loan Scheme (ALDL)	PFI's own funds and Government interest subsidy	To establish scientific dairy farming and allied activities.	5,000	647	8% For small dairy projects. 12% For milk and crop processing.
2	Micro, Small and Medium Enterprises Sector					
2.1	Matale Regional Economic Advancement Project - Revolving Fund (MREAP - RF)	IFAD*	Raising the income of rural and farm families by providing funds for small and medium scale enterprises in the District.	77		10%
2.2	Sabaragamuwa Province Integrated Rural Development Project -Revolving Fund (SPIRDP-RF)	GOSL	Promoting income generating activities in the project area.	100	3	10%
2.3	Sabaragamuwa Province Integrated Rural Development Project (Phase II) - (SPIRDP - II)	GOSL	Promoting income generating activities in the project area.	70	18	12%
2.4	EIB Post Tsunami Line of Credit Contract B	EIB*	To assist the affected small and medium scale enterprises for resumption of business in the Tsunami affected Districts.	1,574	77	9%
2.5	Post Tsunami Coastal Rehabilitation & Resource Management Programme (PTCRRMP) (see foot note 1)	IFAD	To assist the communities affected by Tsunami disaster through recovering their assets and re-establishing the foundation of their usual activities.	148	13	8% - 10%
2.6	Construction Sector Development Project (CSDP)	AFD*	Financing the purchase of machinery by companies rated by the Institute of Construction, Trade and Development for post Tsunami reconstruction activities.	1,400	33	9%
2.7	"Awakening North" Loan Scheme	CBSL	To assist IDPs and others settled in the Northern Province to restart their economic activities.	2,000	722	9%
2.8	"Resumption of Economic Activities in the Eastern Province" Loan Scheme	CBSL	Enhancing living standards of the Eastern Province community by financing existing and new income generating activities.	1,000	256	9%

2.9	The Prosperity Loan Scheme (Saubagya)	CBSL	To start up or expand any micro, small and medium scale enterprise (MSME) or any MSME affected by disasters.	2,900	1,531	9%-10%
2.10	Self Employment Promotion Initiative Loan Scheme (SEPI)	GOSL	To provide financial assistance to youth trained by recognised vocational training institutions.	100	57	10%
2.11	Provincial Development Credit Scheme	CBSL	To assist income generating activities of medium and large scale projects in Agriculture, Animal Husbandry, Fisheries, SMEs, Trade and Transport sectors.	2,900	486	12%
3.	Microfinance Sector					
3.1	Dry Zone Livelihood Support and Partnership Programme	IFAD	Poverty alleviation and assisting in income generation among the poor farmers in the Districts of Monaragala, Kurunegala, Badulla and Anuradhapura.	247	90	10%
3.2	Small Holder Plantation Entrepreneurship Development Programme (SPEnDP) (see foot note 1)	IFAD and USAID*	Improving the livelihood of marginalised small holders of tea and other perennial crops in the mid country region and poor upland food crop farmers in the intermediate zone of Monaragala District to take up rubber cultivation.	295	23	9%
3.3	Small Farmers & Landless Credit Project - Revolving Fund (SFLCP - RF)	GOSL	Channelling formal credit to income generating activities for the rural poor to improve the economic conditions and general welfare of the beneficiaries.	328	115	14%
3.4	Poverty Alleviation Microfinance Project - Revolving Fund (PAMP - RF)	GOSL	Poverty alleviation through promotion of income generating activities and organising low income groups to link them with the formal banking system.	1,031	168	12%
3.5	Poverty Alleviation Microfinance Project II (PAMP II) (see foot note 1)	GOSL JICA*	Poverty alleviation through promotion of income generating activities and organising low income groups to link them with the formal banking system.	2,104	1,024	12% - 15.5%

1. Loans given in 2.5, 3.2 and 3.5 are in foreign currencies of SDR 1.02 million, SDR 1.75 million and JPY 2,100 million respectively and the conversion to Rupees at the exchange rate prevailed on the date of the loan agreement.

* IFAD; International Fund for Agricultural Development
AFD; Agence Française De Développement
JICA; Japan International Cooperation Agency

EIB; European Investment Bank
USAID; United States Agency for International Development

Agriculture and Animal Husbandry Sector

In 2011, PFIs have disbursed Rs. 7,538 million worth of loans through several credit schemes implemented by RDD on agriculture development. This was an increase of 83 per cent over the previous year. The increase in credit delivery was instrumental in increased production of agricultural produce to the domestic market which in turn helped stabilising the food prices in 2011.

New Comprehensive Rural Credit Scheme (NCRCS), which provides working capital requirements of small farmers, granted Rs. 3,495 million among 58,844 farmers during 2010/11 Maha season. This indicated a growth of 73 per cent, in terms of value of loans and 40 per cent in terms of number of loans, over the corresponding season of the previous year. Amount of loans granted in 2011 Yala season under the NCRCS was Rs. 2,924 million, an increase of 88 per cent over the corresponding Yala season in the previous year. The number of farmers benefitted was 39,749 compared to 30,041 farmers in the previous Yala season. This increase in loan disbursement was reflected in cultivated land area of paddy and other crops. Paddy

represents 64 per cent of the loans provided under the NCRCS while onion represents 19 per cent. The balance was shared by potato, maize, chillies, vegetables and other food crops. Jaffna emerged as the District that accounted for the highest amount in agricultural loans under the NCRCS, followed by Polonnaruwa, Anuradhapura and Killinochchi Districts.

Agro Livestock Development Loan Scheme (ALDL), which was introduced to promote liquid milk production in the country, provided financial facilities to medium scale investors in the private sector for construction of stores/factories, and purchase of machinery and equipment for liquid milk processing plants, poultry framing and agro processing industries. In 2011, PFIs granted Rs. 647 million among eligible recipients under the ALDL, reflecting an increase of 48 per cent over the previous year. Of this amount, 89 per cent was granted to promote liquid milk production of which the Eastern Province, where dairy industry is a widespread economic activity, claimed the highest amount of loans (27 per cent) granted for liquid milk production. In 2011, seven Dairy Resources Centres

were opened at Keppetigala, Melsiripura, Girandurukotte, Monaragala, Hatton, Galewela and Medirigiriya to facilitate farmers for purchasing and selling of their milch cows. Further, using the Policy Stimulus Fund, incentives were paid to 108 Livestock Development Instructors (LDIs) to the tune of Rs. 4 million on account of their performance in 2010.

Meanwhile, "Viskam" loan scheme commenced in 2011 granted loans amounting to Rs. 356 million for agriculture and animal husbandry activities island-wide. The novelty of this project is that it promotes the concept of agribusiness among the farmers providing high net-worth loans to farmers for value added industries such as agro and milk based industries, dairy projects, breeding farms, demonstration farms, innovative projects etc. In addition, Second Perennial Crops Development Project-Revolving Fund Loan Scheme granted Rs. 110 million among eligible borrowers for perennial crops development while Tea Development Project-Revolving Fund Loan Scheme provided Rs. 7 million.

Promoting SME Financing and Employment Generation

In 2011, RDD continued to assist SME sector with number of loan schemes. Saubagya Loan Scheme, initiated in 2010, provides credit facilities for micro, small and medium scale enterprises (MSMEs), other than the activities in agriculture, livestock and fisheries subsectors. This scheme, covers the entire Island, provides loans up to a maximum of Rs. 25 million to start MSMEs. In 2011, Rs. 1,531 million was disbursed among 3,509 recipients under this scheme. Most of the small loans granted under Saubagya scheme were given for cottage industries, small businesses and brick and tile manufacturing while large size loans were granted for processing of coir, modification of restaurants and manufacturing garment accessories.

Provincial Development Credit Scheme that was also introduced in 2010 with the objective of provisioning capital for medium and long term projects in the SME sector disbursed Rs. 486 million to eligible projects. Meanwhile, Self Employment Promotion Initiative Loan Scheme (SEPI), aimed at providing financial assistance for the youth trained at recognised vocational training institutions in the country for establishment of self employment projects, granted loans amounting to Rs. 57 million in 2011.

Several other schemes that aimed at SME promotion and employment generation operated during 2011 were EIB Post Tsunami Line of Credit Contract B, Construction Sector Development Project (CSDP) and Sabaragamuwa Province Integrated Rural Development Project-Revolving Fund (SPIRDP-RF).

Development of Conflict Affected Regions

During the year under review, RDD continued to focus on enhancing economic development in the Northern and Eastern Provinces. With the end of the conflict RDD introduced two special loan schemes for the two Provinces

i.e. "Awakening North" and "Resumption of Economic Activities in the Eastern Province" with a view to boost the livelihood development of the people and assist Internally Displaced Persons (IDPs). The two loan schemes provided financial assistance for the resumption of economic activities in agriculture, livestock, fisheries, micro and small enterprises and trade and other self employment projects in the Provinces. Under the Awakening North Loan Scheme, 4,724 loans amounting to Rs. 722 million have been granted by the PFIs while 1,720 beneficiaries received loans amounting to Rs. 256 million under the Resumption of Economic Activities in the Eastern Province Loan Scheme. The available funds to disburse loans under the two schemes were fully utilised by the PFIs in 2011.

With the peaceful atmosphere that prevailed during the year, the other development loan schemes performed well in the two Provinces. Provincial Development Credit Scheme allocated the highest amount of funds, Rs. 900 million, for the Northern Province, where the Province claimed 32 per cent of the total amount of loans granted in 2011. Saubagya Loan Scheme released Rs. 115 million in the Northern Province and Rs. 54 million in the Eastern Province while the other SME sector loan schemes also granted considerable amount of loans in these two Provinces. Of these, the performance of the agricultural loan schemes was noteworthy. RDD also targeted to reach poor households in the two Provinces under the Poverty Alleviation Microfinance Project II (PAMP II) with the assistance of PFIs during the year. The number of beneficiaries enrolled under PAMP II in the Eastern Province was reported at 14,358 during the year. Of these, 8,434 beneficiaries were granted micro loans of Rs. 400 million. In the Northern Province, the PAMP II enrolled 12,206 applicants of which, 5,341 beneficiaries received loans to the value of Rs. 302 million during the year 2011.

Poverty Alleviation and Employment Generation

The poverty alleviation strategy of the RDD focused on outreaching people who were excluded from formal financial sector, as well as literate them in financial management and provide them loans to commence income generating activities. In this exercise, RDD expected to build sustainable microfinance networks in the regions.

Poverty Alleviation Microfinance Project II (PAMP II), funded by Japan International Cooperation Agency (JICA), continued to operate in 14 Districts in the country in 2011. The number of beneficiaries enrolled under the PAMP II during the year was 38,160 and out of these, 20,656 beneficiaries had been granted loans to the value of Rs. 1,024 million to commence income generating activities. This was an increase of 57 per cent over the amount of loans granted in the previous year. Of the total loan amount, 39 per cent was disbursed for trading and other services while livestock (21 per cent), agriculture (19 per cent) and small industries (15 per cent) followed.

Meanwhile, the Small Farmer and Landless Credit Project-Revolving Fund (SFLCP-RF), that intends to improve economic well being and general welfare of the rural

poor, also progressed in 2011 by granting of loans to the value of Rs. 115 million among 4,697 beneficiaries. The Dry Zone Livelihood Support and Partnership Programme disbursed Rs. 90 million worth of loans to 1,538 beneficiaries in Anuradhapura, Badulla, Monaragala and Kurunegala Districts.

Value Chain Development

RDD commenced its new development assistance programme in 2011, National Agribusiness Development Programme (NADeP), funded by International Fund for Agricultural Development (IFAD).

The NADeP aims at assisting smallholder farmers by increasing the incomes of beneficiaries participating in value chain development by 30 per cent through a combination of improved farm gate prices, farm productivity and participation in upstream value added processing. The value chain development includes two broad divisions, private sector led marketing chain development and Community Based Organisations (CBOs) led marketing chain development targeting over 40,000 farmer families. The NADeP will assist private sector agribusiness companies and CBOs to create public companies with tripartite equity contribution namely, investor company/CBO, beneficiaries and the NADeP.

During 2011, the NADeP called for Expressions of Interest (EOIs) from the reputed agribusiness companies and CBOs and the parties who sent EOIs which can be developed into proper business plans were invited for workshops on business plan preparation. After attending these workshops 14 agribusiness companies and 11 CBOs submitted their business plans which were evaluated and selected projects are to be commence operations during 2012.

Promoting Financial Inclusion

In order to promote financial inclusiveness RDD conducted 123 financial literacy programmes. These programmes were conducted Island-wide with the cooperation of PFIs.

23. SECRETARIAT

In 2011 Secretariat Department (SD) continued to facilitate efficient functioning of the CBSL through timely procurement of goods and services, continuous assessments and upgrading of the operational systems and procedures, administering and implementing rules and regulations in respect of leave, superannuation funds and local and foreign travel.

The SD procured capital and non-capital goods and services amounting to Rs.160.36 million, mainly through tenders by assuring and maintaining quality, timeliness, and competitive prices. As in the past, procurement planning was continued further to monitor the procurement management process of the CBSL in order to streamline the timely supply of goods and services to the user departments. As a result, the SD was able to complete 93 per cent of the total procurement requirements of the Bank planned for the year. In addition, the SD obtained

a cost effective and comprehensive insurance cover for all CBSL properties. SD administered the Central Bank Pension Scheme, Widows' and Orphans' Pension Fund (W & OP) and Widowers' and Orphans' Pension Fund (WR & OP). The total number of pensioners enrolled under these schemes at the end of 2011 was 2,016.

During the year, SD continued to provide the Bank with legal services. Such services were made available in a wide array of activities ranging from routine legal issues to policy formulation so as to catalyze the activities of the Bank.

In handling litigation, a proactive role was played to assert and defend the rights of the Bank. In order to facilitate smooth handling of diverse challenges before the Bank, necessary assistance was provided by preparing suitable laws and by-laws in respect of the banking and financial sector.

In 2011, the SD coordinated and organized various religious and commemorative events and annual ceremonies such as long service award ceremony, and Independence Day ceremony.

24. SECURITY SERVICES

The Security Services Department (SSD) is responsible for facilitating the carrying out of functions of the Central Bank of Sri Lanka (CBSL) without any security threats and free of incidence. In performing duties under this responsibility, the department attended to strengthen the security of the CBSL with the help of its staff and that of Sri Lanka's security forces and Police with a view to protecting CBSL's employees, buildings, properties and currency consignments in transit. SSD restricted entering unauthorized personnel and goods into the CBSL premises while providing around the clock security service. The automated Visitor Monitoring and Management System, which was introduced last year at the head office, was further improved to minimise the time taken to check and clear incoming visitors and material without causing any inconvenience to the general public. Action was also taken to improve the security services by installing additional CCTV cameras and repairing and replacing the fire & safety equipment at the Centre for Banking Studies (CBS), Lloyds building, provincial offices and holiday bungalows located outside the head office.

In order to improve the skills of the security officers, SSD arranged several educational programmes for its staff. Under these, all security officers followed a basic English course, participated in a workshop on improving Public Relations and 13 officers participated in a Tamil Language course. Further, 08 staff officers and 110 non-staff officers in the department attended several workshops conducted locally. These workshops covered the areas of Security, Information Technology, Leadership and Office Management. Two staff members participated in two training programmes in Singapore during the year.

With the assistance of the Sri Lanka Air Force, Colombo Fire Brigade and St. Jones Ambulance, the department arranged to conduct a two day comprehensive training programme on fire fighting, fire preventing and first

aid treatment to ninety five fire wardens and ten other participants selected from different departments, CBS, provincial offices and holiday homes of the CBSL.

Sri Lanka Army conducted weapon and live firing training for all security officers of the CBSL during the year 2011. Staff of the SSD participated in all business continuity planning drills of the CBSL. The department also provided security services to all functions arranged by different departments of the CBSL outside the CBSL premises. The SSD was able to complete another successful year with free of security related incidents.

25. STATISTICS

The Statistics Department (STD) collects, compiles, analyses data and forecasts trends pertaining to core objectives of the Central Bank with a view to assess macro economic conditions, facilitate policy formulation process of the Central Bank, assist researchers and analysts and disseminate information to enhance public awareness. With a view to improving transparency and public confidence, the department released socio-economic information to the public on a regular basis through annual, monthly and weekly publications.

25.1 Statistical Surveys

The Monthly Inflation Expectation Survey which was initiated in 2006 was continued. The perception of current inflation and expected inflation was measured using a sample of around 300 chosen from banks, financial institutions and other organizations and findings were used for Monetary Policy formulation purposes. The land price survey, which was initiated in 2006 too was continued, and a Land Price Index was computed on a half yearly basis.

During 2011, the STD conducted two special surveys on Fish Production and Prices and Availability of Facilities for Rest and Recreation during the year. The objective of the Fish Production and Prices survey was to assess the future prospects of the marine fish production and to identify the existing constraints for improving the marine fish production and marketing. The survey was conducted in an ad-hoc manner and qualitative information on fish production was collected from the key stake holders of the fishing industry. A detailed report including major issues identified through the survey and measures to be taken to increase the fish production was submitted to the Ministry of Fisheries and Aquatic Resources Development.

A survey was undertaken to assess availability of facilities for rest and recreation in the Guest Houses, Holiday Bungalows and Circuit Bungalows managed by the institutions under the respective Ministries. A rapid expansion in both domestic and foreign tourism industry would demand a substantial increase in hotel rooms, rest and recreation facilities, in the near future and the survey findings would be useful for formulating future plans for tourism industry. According to the survey, there are 2,126 rooms belonging to 480 housing units managed by the 34 Government Ministries. The survey report was submitted to the Ministry of Economic

Development. The compilation of a Prosperity Index for year 2010 covering nine provinces was completed and time series data of this index reveals the trends in socio-economic progress made at provincial level.

25.2 Improving Doing Business Ranking

The STD continued the special project for improving the "Ease of Doing Business Ranking" in Sri Lanka, initiated in 2010. Any improvement in relative ranking of Sri Lanka under this index would indicate the soundness of business environment enhancing the confidence of foreign investors. For this purpose the department organized two high level seminars during the year for Secretaries of Ministries and high officials to map out a strategy to improve Sri Lanka's ranking. In addition, STD conducted a seminar for data providers on recent development in Doing Business environment and participated in two video conferences with Doing Business Team in the World Bank in order to communicate recent development pertaining to Doing Business reforms. As a result, Sri Lanka's Doing Business ranking improved to 89 in 2012 from 98 in 2011 mainly due to improvement in the area of investor protection. An information booklet titled "A Step by Step Guide to Doing Business in Sri Lanka" was revised and published to give effect to government budget proposals in 2011.

25.3 Country-Wide Data Collection System (CWDCS)

The Country-Wide Data Collection System (CWDCS) completed its thirty three years of operation in 2011, addressing island-wide market information needed for policy makers. This system operated through an island-wide network of government school teachers. They function for 102 data collection centres operated in the island, including 19 data collection centres in the Northern and Eastern provinces. Information on retail prices of consumer goods, producer prices of agricultural commodities and daily wage rates pertaining to the informal sector was collected under this programme. Collection and dissemination of wholesale and retail prices of major food items from the Pettah market and other centres such as the Marandagahamula rice market and the Dambulla and Narahenpita Special Economic Centres were carried out by non-teacher investigators appointed by the Department. Data collected under the system is used for the compilation of price indices, forecasting price movements, evaluation of the impact of policy changes on prices and estimation of national expenditure and income. Data collection process was improved in order to capture the recent developments in the markets such as non-availability of some products / trade names, emerging new products or economic activities and changes in unit sizes.

The quality and timeliness of data collection was further strengthened through regular on-site and off-site supervision and continuous monitoring of the data forwarded by the investigators. In addition, accuracy of this data was further verified through cross checking with the data collected from selected markets in the Colombo district, by the STD officers. Supervision activities of

selected data collection centres which are located within the vicinity of the Provincial Offices of the CBSL (POs) were continued through the respective POs, with a view to further strengthening the CWDCS. Besides, five regional seminars were conducted in Colombo, Matara, Anuradhapura, Kandy and Killinochchi in 2011 to provide required guidance for the data collectors. In addition to the one to one discussions, these seminars provided an opportunity, particularly to share experiences of Tamil speaking teacher investigators in the Northern and Eastern provinces and to discuss issues relating to operation of the programme. At these programmes, special sessions were also conducted to educate them on contemporary developments in the economy in the areas such as Improving Doing Business Ranking, revised CCPI and highlights in the Central Bank Annual Report – 2010. An early-warning system using the CWDCS was also introduced in 2011 in order to further improve inflation and GDP projections.

25.4 Prices, Wages, Employment and Productivity

The Department continued with regular and close monitoring of the movements of consumer prices based on the Colombo Consumers' Price Index (CCPI) compiled by the Department of Census and Statistics (DCS) and issuing monthly press releases and analysing price developments. Projections for short term and medium term inflation were prepared by the STD to be used as leading indicators of the future direction of price movements. In addition, analytical framework was developed in order to make CCPI projections sensitive to contemporary price developments in specific items and tariff changes.

The Department worked with close collaboration with the DCS in connection with rebasing the CCPI with the base year of 2006/07 in order to produce a more representative price index which capture recent changes in consumption patterns. This was based on the Household Income and Expenditure Survey (HIES) conducted in 2006/07 by the DCS. Under this revision, the basis of computation of the Core Inflation Index was also changed in consultation with the Central Bank. Accordingly, instead of excluding total food and energy items from the overall CCPI basket, the new Core Inflation Index was computed by excluding fresh food, energy, transport, rice and coconut from the basket. This is considered as a more appropriate indicator that could be targeted for monetary policy with a greater effectiveness.

Besides, the Department compiled and analysed nine provincial consumer price indices, which measured the aggregate price movements at provincial level. These indices were based on the Consumer Finances and Socio Economic Survey (CFS) of 2003/04. In addition, a composite CPI covering the entire country was also compiled by the STD. The prices necessary for the compilation of these indices were mainly collected through the CWDCS.

The Department continued to monitor the price movement of selected food items, with a view to estimating the likely impact on the CCPI. This information was also reported weekly to the Ministry of Economic Development for policy purposes.

The Department also compiled informal sector wages, based on the CWDCS wage data. The sub-sectors covered included paddy, tea, rubber and coconut cultivation, small-scale industry, construction and services. In addition, wage rate indices for the public sector which cover the non-executive grades and minor employee grades in the central government and the government school teachers were also compiled and analysed by the STD. Wages in the formal private sector were monitored by the STD through the minimum wage rate indices computed by the Department of Labour.

Meanwhile, the STD continued with compiling the Wholesale Price Index (WPI) to analyse movements in prices at the primary market level. Based on the study carried out in 2010, the weight structure for revision of the current WPI was finalized. Data collection work pertaining to producing a new WPI was also carried out in 2011.

The Annual and Quarterly Public Sector Employment Surveys (QPSES) were conducted by the STD in 2011. The purpose of these surveys was to find the levels and trends in public sector employment and assess the effectiveness of the current employment policy of the country. It is also used to estimate quarterly national income statistics. The quarterly survey covered all Central Government, Local Government and Semi-government institutions with over 1,000 employees each as reported in the Annual Public Sector Employment Survey (APSES) of 2010. Information collected on labour force and labour market covering the areas of foreign employment, labour relations and labour market reforms, and labour productivity was also analysed by the STD.

25.5 National and Regional Income

The process of monitoring the developments in the real sector of the economy and compilation of national income projections continued during 2011. This included collection of primary and secondary data, analysis of developments in the economy and forecasting future trends in production, consumption, savings and investments in the country. Reliability of national income projections was further improved by adding a number of new variables.

The Department continued to compile Gross Domestic Product at Provincial Level (PGDP). These statistics reveal the provincial contribution to the national GDP. The information on PGDP is useful to the provincial authorities as well as the national planners of the central government to introduce and implement appropriate strategies to lower income disparities among provinces. Further, STD continued to liaise with DCS which bears the responsibility in compilation of official national income estimates for the country enabling, the smooth flow of information between two institutions.

25.6 Dissemination of Statistics

The STD released its two annual publications titled "Economic and Social Statistics of Sri Lanka 2011 – Volume XXXIII" in April 2011 and "Sri Lanka Socio Economic Data 2011 – Volume XXXIV" in June 2011. During the year, the STD made its regular contributions to statutory and

other publications of the Bank. The Monetary Board was kept informed of the current developments with regard to national income, inflation, prices, wages, and the labour market, as and when necessary. The Departmental Website on the local area network, StaNet and the CBSL website were updated on a regular basis.

26. SUPERVISION OF NON-BANK FINANCIAL INSTITUTIONS

The Department of Supervision of Non-Bank Financial Institutions (SNBFI Department) was established under the Finance Companies Act, No. 78 of 1988 (FCA) to regulate and supervise Licensed Finance Companies (LFCs). The FCA was repealed and replaced by the Finance Business Act, No.42 of 2011(FBA) on 09. 11. 2011. This new Act has further strengthened the supervisory and investigation powers, provided a broader definition for finance business and enhanced penalties for offences. The department's scope also includes regulation and supervision of finance leasing business under the Finance Leasing Act, No.56 of 2000 (FLA). The supervisory responsibilities of the department include formulation and implementation of prudential requirements, conducting continuous supervision, periodic statutory examinations, granting specific approvals, resolution action on weak companies under supervision, investigation and legal action on conduct of finance business without authority and conduct of public awareness programmes. As at end 2011, there were 39 LFCs and 71 Registered Finance Leasing establishments (RFLEs) comprising of 13 Licensed Commercial Banks, 5 Licensed Specialised Banks, 37 LFCs and 16 Specialised Leasing Companies (SLCs) in operation. The names of these LFCs and RFLEs are provided in Annex II-2. However, only LFCs and SLCs come under the supervisory purview of the SNBFI Department as Non-Bank Financial Institutions (NBFIs).

26.1 Issue of Directions and Prudential Requirements

New prudential requirements were introduced with the approval of the Monetary Board in 2011 to NBFIs, which are summarised below. Details of the same are provided under Part III of this report.

(a) Regulations to LFCs

i. **Increase of the minimum core capital:** In view of the envisaged increase in business demand, it was considered necessary to strengthen the capital base of the LFCs to ensure that the companies have the ability to absorb increased risk. Hence, the minimum capital requirement of LFCs was increased to Rs.400 million on a staggered basis as indicated below.

Existing LFCs		New LFCs	
Effective date	Amount (Rs. Mn)	Effective date	Amount (Rs. Mn)
Up to end of December 2012 (transitional period)	200	02.08.2011	400
01.01.2013	300		
01.01.2015	400		

- ii. **Enhanced reporting requirements:** Reporting of information on financial performance of the LFCs is essential to the regulator for effective supervisory oversight. Hence, the enhanced reporting requirements specify reporting formats, time lines as well as sanctions for non-compliances.
- iii. **Introduction of assessment of fitness and propriety of directors and officers performing executive functions:** Fitness and propriety of directors and officers performing executive functions is a key requirement to ensure good governance and risk management on conduct of business of LFCs which promotes the stability of such companies. Therefore, criteria for assessment of the fitness and propriety of the directors and officers have been specified in this direction. Accordingly, directors and officers performing executive functions are required to submit affidavits and declarations with respect to their fitness and propriety as per the formats given.
- iv. **All LFCs to be listed on the Colombo Stock Exchange:** In order to improve transparency and accountability as well as to build public confidence, all LFCs thus far not listed were given a deadline to list on the Colombo Stock Exchange (CSE) by 30 June 2011. As at end 2011, 28 LFCs were listed. The Monetary Board has granted extended time to 6 companies inclusive of the 5 distressed companies and one company has been exempted from the listing requirement pending a merger. The remaining four companies are expected to be listed during 2012.
- (b) **Regulations to SLCs**
- i. **Introduction of capital adequacy ratios:** The risk weighted capital adequacy ratios were introduced to SLCs sector to ensure that SLCs are adequately capitalized to mitigate risks. Accordingly, SLCs are required to maintain a capital adequacy ratio of 10 per cent and a core capital ratio of 5 per cent of its total risk weighted assets.
- ii. **Approval for structural changes:** A structural changes direction was issued requiring SLCs to obtain prior written approval from the Central Bank with regard to selling of the business, establishment of subsidiary companies, changes to issued capital and any other corporate changes.

iii. **Introduction of liquid assets requirement:** A liquid assets direction was introduced in order to minimize liquidity risk as SLCs mobilize funds through issuing debt instruments. The statutory liquid assets requirements for SLCs are, 5 per cent of the total liabilities (less liabilities to shareholders) with effect from 01.01.2012 and 10 per cent with effect from 01.01.2013.

(c) **Regulations to NBFIs**

i. **Listing of future debenture issues:** All the NBFIs have been advised to consider listing any future debenture issues on the CSE in view of better market transparency and discipline.

ii. **Guidelines on the operations of the Investment Fund Account (IFA):** The operational guidelines issued in relation to the IFA, to NBFIs on 12.05.2011 as per the 2011 budget proposals. The IFA could only be used for the purposes of lending to sectors such as agriculture, SME sector, education, housing, and tourism related areas or in long-term government securities.

26.2 Issue of licences and granting regulatory approvals

(a) During 2011, the total number of LFCs increased from 37 to 39 with two SLCs migrating to LFC status. Meanwhile, 4 RFLEs were registered under FLA while 3 SLCs licences were cancelled namely; Lanka ORIX Leasing Company PLC, Kalutota Investment & Leasing Ltd and Ceylinco Leasing Corporation Ltd. Accordingly, the total number of RFLEs increased by one to 71 during the year.

(b) Approvals for 136 new NBFi branches were granted during the year out of which 28 were opened in Northern and Eastern Provinces.

(c) Further, approvals were granted to the following companies to change their names i.e., People's Merchant Finance Company Ltd. as Capital Alliance Finance PLC, Industrial Finance Ltd. as City Finance Corporation Ltd., Nanda Investments Ltd. as Nanda Investments & Finance Ltd., Grameen Micro Credit Company Ltd. as Prime Grameen Micro Finance Ltd., Capital Reach Credit Ltd. as Softlogic Credit Ltd., Asia Commerce Ltd. as Divasa Finance Ltd. and People's Merchant Bank PLC as People's Merchant PLC.

26.3 Off-site supervision of NBFIs

(a) Continuous off-site surveillance was carried out by analysing financial information received through periodic returns submitted by NBFIs. Such analysis provides a basis for identifying early warnings on adverse conditions of these institutions that need further examination and corrective action. Where necessary, meetings with Boards of Directors, senior management and auditors were also held to resolve any adverse situations.

(b) The Governor's meetings with the CEOs of NBFIs were conducted on a quarterly basis with a view to enhancing the industry capacity. The salient issues discussed at these meetings inter alia were mitigation of risk arising from exposure to the equity market, implementing good corporate governance practices, listing of LFCs on the CSE, need of a strategic business plan and implementation of the new IFRS regulations.

26.4 On-site examination of NBFIs

(a) Periodic on-site examinations were carried out to assess the liquidity, asset quality, capital adequacy, management efficiency, earnings, profitability, system controls and the status of corporate governance of NBFIs. A risk based approach was adopted in carrying out these examinations where the focus was on identification of risks, management of risks and assessment of resources to mitigate risks. During 2011, the SNBFI department conducted on-site examinations on 17 LFCs and 6 SLCs. The examination reports highlighting any risks identified and recommendations for corrective actions were provided to the respective Boards of Directors. Main supervisory concerns raised inter alia were non-compliance with the direction on corporate governance, improvements needed for better risk management and lack of prudence in dealing with related parties.

(b) In addition, 12 LFCs and 3 SLCs were examined on a limited scope basis, selecting critical areas such as liquidity, credit administration, asset portfolio, capital adequacy and system controls. The Boards of Directors of respective entities that were identified with significant supervisory concerns were required to submit firm commitments with specific timeframes for corrective action.

26.5 Business revival plans of distressed NBFIs

During the year 2011, 7 companies including one SLC, affected by the liquidity crisis were restructured. The major measures included, appointment of Managing Agents to oversee the management of these companies, restructuring of the balance sheet by way of capitalisation of deposits (approximately Rs. 6 billion) and bringing in new strategic investors (approximately Rs.5.3 billion) with a long-term view. The SNBFI closely monitored the performance of these distressed companies through regular meetings held with Boards of Directors, Senior Management, the Managing Agents and prospective investors. Further, SNBFI department obtained professional support of the Expert Panel of 4 members appointed by the Cabinet of Ministers in 2009, to review the business revival plans. The progress of these restructuring measures are as follows;

- a) Managing Agents have now been released from 4 companies.
- b) Balance sheets of 5 companies have been restructured by way of converting deposits and debt into equity (four have been completed and one is in progress).

- c) Strategic investors were found for all the seven distressed companies while strategic investments have been completed and Boards of Directors reconstituted, in six companies.
- d) Five companies have commenced normal business operations.
- e) All distressed NBFIs are envisaged to revitalise their businesses fully and obtain listing during 2012.

26.6 Other Activities

(a) The Finance Business Act, No.42 of 2011

In May 2010, the Cabinet of Ministers granted approval to introduce new legislation to regulate finance business. The Cabinet of Ministers on 29th December 2010 granted approval for the draft bill to be submitted to the Parliament. The FBA was passed by the parliament in September 2011 and was certified by the Speaker of Parliament on 09.11.2011 and is in operation now by repealing and replacing the FCA. The FBA has empowered the SNBFI department with more investigative powers and enhanced penalties for offences, with a broadened definition for finance business.

(b) The proposed Micro Finance Act

Under the proposed regulatory mechanism, an independent authority is to be established to regulate and supervise microfinance institutions. Consequent to a proposal submitted by the Central Bank to the Ministry of Finance and Planning, the Cabinet of Ministers granted approval in July 2010 to draft a microfinance bill.

(c) Public Awareness Programmes

Educating the public of the risk of investing in unauthorized finance business was done through public awareness programmes. These programmes were specifically held in rural areas. 53 public awareness programmes were conducted in Kandy, Nuwara Eliya, Anuradhapura, Polonnaruwa, Matale and Matara districts by way of seminars and radio broadcasts. The Radio broadcasts were conducted jointly with the Sri Lanka Broadcasting Corporation. A short film named 'paninata pera' was telecast over 9 TV channels. Further, 8,500 posters containing lists of Licensed Banks and LFCs have been distributed among Grama Niladharies in 16 districts. 31,000 Leaflets containing lists of Licensed Banks and LFCs with other useful information to public were distributed among the public. The list of institutions authorised to accept deposits were published in the newspapers in all three languages.

(d) Investigation on conduct of finance business without authority

During the year 2011, the SNBFI Department commenced investigations on 08 persons/institutions under the Section 11 of the FCA based on the complaints it received and continued investigations on 66 other institutions.

Licensed Finance Companies and Registered Finance Leasing Establishments

Institutions registered with the Central Bank in accordance with the law (As at end 2011)	
Licensed Finance Companies	Registered Finance Leasing Establishments
<ol style="list-style-type: none"> 1. Abans Finance PLC 2. Alliance Finance Co. PLC 3. AMW Capital Leasing PLC 4. Arpico Finance Co. PLC 5. Asia Asset Finance Ltd. 6. Asian Finance Ltd. 7. Associated Motor Finance Co. PLC 8. Bartleet Finance PLC 9. Bimpuh Lanka Investments PLC 10. Capital Alliance Finance PLC (Formerly, People's Merchant Finance Ltd.) 11. Central Finance Co. PLC 12. Central Investments and Finance PLC 13. Chilaw Finance Ltd. 14. Citizens Development Business Finance PLC 15. City Finance Corporation Ltd. (Formerly, Industrial Finance Ltd.) 16. Commercial Credit PLC 17. Commercial Leasing & Finance Ltd. 18. Divasa Finance Ltd. (Formerly, Asia Commerce Ltd.) 19. Edirisinghe Trust Investments Ltd. 20. Kanrich Finance Ltd. 21. L B Finance PLC 22. Lanka ORIX Finance Co. PLC 23. Mercantile Investments PLC 24. Merchant Credit of Sri Lanka Ltd. 25. Multi Finance PLC 26. Nanda Investments & Finance Ltd. (Formerly, Nanda Investment Ltd.) 27. People's Finance PLC 28. Prime Grameen Micro Finance Ltd. (Formerly, Grameen Micro Credit Company Ltd.) 29. Senkadagala Finance PLC 30. Singer Finance (Lanka) PLC 31. Sinhaputhra Finance PLC 32. Softlogic Finance PLC 33. Swarnamahar Financial Services PLC 34. The Finance & Guarantee Co. Ltd. 35. The Finance Co. PLC 36. The Standard Credit Lanka Ltd. 37. Trade Finance & Investments PLC 38. Vallibel Finance PLC 39. TKS Finance Ltd. 	<ol style="list-style-type: none"> (A) Licensed Commercial Banks <ol style="list-style-type: none"> 1. Bank of Ceylon 2. Commercial Bank of Ceylon PLC 3. Hatton National Bank PLC 4. MCB Bank Ltd. 5. National Development Bank PLC 6. Nations Trust Bank PLC 7. Pan Asia Banking Corporation PLC 8. People's Bank 9. Sampath Bank PLC 10. Seylan Bank PLC 11. Union Bank of Colombo PLC 12. Amana Bank Ltd. 13. DFCC Vardhana Bank Ltd. (B) Licensed Specialised Banks <ol style="list-style-type: none"> 1. MBSL Savings Bank Ltd. 2. DFCC Bank 3. Lankaputhra Development Bank Ltd. 4. Sanasa Development Bank Ltd. 5. Pradeshiya Sanwardana Bank (C) Specialised Leasing Companies (SLCs) <ol style="list-style-type: none"> 1. Assetline Leasing Co. Ltd. 2. Ceylease Financial Services Ltd. 3. Co-operative Leasing Co. Ltd. 4. Indra Finance Ltd. 5. Isuru Finance Co. Ltd. 6. Koshiba Leasing Co. Ltd. 7. Lisvin Investments Ltd. 8. LOLC Micro Credit Ltd. 9. Merchant Bank of Sri Lanka PLC 10. Nation Lanka Finance PLC 11. Orient Financial Services Corporation Ltd. 12. People's Leasing Co. PLC 13. People's Merchant PLC (Formerly, People's Merchant Bank PLC) 14. Sampath Leasing & Factoring Ltd. 15. SMB Leasing PLC 16. Softlogic Credit Ltd (Formerly, Capital Reach Credit Ltd.) (D) Licensed Finance Companies listed above except Prime Grameen Micro Finance Ltd. and TKS Finance Ltd.

27. WELFARE

The Welfare Department continued to extend the welfare facilities to all beneficiaries in an efficient and effective manner throughout the year 2011. The registered beneficiaries of the WD exceeded 10,200 which consist of employees, pensioners, widows/widowers and their registered dependents. As the loan limit extended further, WD was able to disburse more loans during the latter part of the year. In addition, the WD played a prominent role in providing catering facilities for the special events organized by the various departments of the CBSL.

The WD granted 1,397 loans including Provident Fund Loans, Vehicle Loans, Computer Loans and other loans under the Staff Benefit Scheme during 2011 to provide financial assistance for various needs of the beneficiaries. All loans were granted within three working days after the submission of the application with all relevant documents. The introduction of the loan monitoring system has enabled to disburse loans to employees accurately and quickly.

The CBSL restaurant continued the self-service system in providing breakfast and lunch to the CBSL staff as well as to the staff of other institutions located in the Bank's premises. The tea service provided by the WD was diversified by

adding herbal drinks as evening refreshment for two days per week. In addition, the food and beverage services were extended to all departments and senior management based on special requests, to their satisfaction. Further, all the basic arrangements were made to enhance the restaurant facilities during 2012.

The WD continued to reimburse medical expenditure incurred by all registered beneficiaries. Medical facilities at the medical centre were available for the bank employees during all working hours. Quality of medical services were improved by outsourcing the services from a reputed hospital. The laboratory services were provided at the medical centre at a reasonable price. The automation of the medical centre has been in operation from January 2011 and modifications have been done by ITD as and when required. The e-medical system facilitates to all employees by opening an individual file for each and every employee of the Bank including officers of CBS and Provincial Offices. The WD continued to conduct the annual health camp and in addition five awareness programmes were conducted for the benefit of the staff during the year. All the arrangements were completed by the end of the year to revise the Medical Benefit Scheme for employees and pensioners.