PART II

ACCOUNTS AND OPERATIONS OF THE CENTRAL BANK OF SRI LANKA

Box II - 1

MODERNISATION OF THE CENTRAL BANK

The global changes taking place in the financial markets and the field of technology have compelled the central banks world over to change, in order to acquire the capacity to meet the challenges posed by a modern financial system. Accordingly, the Central Bank of Sri Lanka embarked on a modernisation program *(Refer Part II – Page (II) - Annual Report 2000)*, to meet the emerging needs and challenges of the local and international financial markets. This has resulted in changes to the objectives, functions, structure and processes currently being followed by the Bank.

The modernisation process will lead to strengthening of the Bank's core objectives, viz., price stability and financial sector stability, devolution of non-core functions, organisational changes, adoption of new human resource policies, implementation of a voluntary retirement scheme, introduction of new technology such as payments and settlements system and legal reforms. This process will thus create a lean, modernised and efficient Bank and it will upgrade the core financial system infrastructure to satisfy the needs of an evolving economy in a manner that strikes a balance among different objectives, viz., operational cost, processing efficiency and credit, liquidity, and systemic risks. This programme will therefore help towards implementing further financial sector reforms by an efficient central bank with the ultimate objective of establishing a competitive and prudently managed banking system.

The World Bank through the International Development Agency (IDA), along with the Swedish International Development Agency (SIDA), agreed to provide the necessary funding to support the modernisation process. The total project cost is estimated at US dollars 42 million with an IDA contribution of US dollars 30.3 million and a SIDA contribution of US dollars 1 million. The balance US dollars 10.7 million will be borne by the Central Bank.

During the year under reference the following has been achieved under this modernisation program.

Human Resource Development

In order to move towards a streamlined management culture with a greater degree of professionalism, the Bank has initiated action to adopt new human resource policies. For this purpose, the following activities were carried out during the year under review:

- Consultancy services of PricewaterhouseCoopers were obtained to study and recommend Human Resource (HR) policy changes necessary for the modernised Central Bank.
- A Management Development Centre was established to train the managers and expose them to new knowledge so that they could play a key role in the change management process and discharge of the new functions of the Bank through education, awareness raising, critical analysis and continuous evaluation of processes and activities.
- The recruitment process towards engaging the services of a Human Resource Manager was commenced, in order to set up a modern human resource department and implement suitable new human resources policies in the Bank.

Voluntary Retirement Scheme

The restructuring process entails, among other things, redesigning the objectives, functions and structure of the Bank, studying the work process and automation of activities, reassessment of human resource needs, redesigning jobs and assigning some of the functions to outside agencies. In this process, it was evident that some categories of employees were most likely to be redundant. Accordingly, the Bank offered a Voluntary Retirement Scheme (VRS) to certain categories of employees. The scheme offered adequate compensation/ retirement package and it encouraged many employees to opt for the VRS.

The VRS was successfully implemented during the year under review and 588 employees retired from the Bank's service by the end of December, 2001. Another 103 employees will retire from the Bank's service on a staggered basis within the first half of 2002.

Organisation Structure

In the proposed reorganisation, one of the key components was the strengthening of the core objectives of the Bank and devolution of the non-core objectives. Accordingly a new organisation structure focussing on the core objectives and functions has been designed. Under this proposed organisational structure, departments have been categorised under the primary objectives or functional groups, i.e., price stability, financial system stability, agency and business functions and corporate services. In this process, the following changes were implemented:

- The Regional Development Department was established by the amalgamation of the Rural Credit Department and the Development Finance Department.
- The Banking Department was reconstituted into four new departments, viz., International Operations Department, Domestic Operations Department, Payments and Settlements Department and Finance Department.
- The completion of the due diligence study and valuation of assets of the Sri Lanka Automated Clearing House, which is envisaged to be divested in April 2002 to Lanka Clear (Pvt) Ltd., an organisation jointly owned by the Central Bank and commercial banks.

Payments Reforms

The proposed payment reforms seek to achieve the establishment of the infrastructure required to support the development of Sri Lanka's financial markets and banking sector, reduce settlement risk in the payments system and securities settlement system in line with emerging best international practice, enhance the integrity and tradability of Sri Lanka's public debt, improve efficiency and quality of CBSL's financial and business operations, and establish an appropriate legal and regulatory framework to underpin the new operational mechanisms.

In order to achieve the above objectives, action was initiated to introduce a Real Time Gross Settlement System (RTGS)/ Scripless Securities Settlement System (SSSS). The RTGS system will be used basically to transmit time critical large value payments. The SSSS will ensure that Sri Lankan securities settlement system conforms to international standards and assist to facilitate a more active secondary market in the trading of government securities, while overcoming inefficiencies in the market related to paper securities. In addition, an integrated accounting system / automated general ledger is proposed to be procured for the Bank to facilitate the above and support CBSL's current and future financial operations.

For the above purpose, the Bid documents for the procurement of the RTGS/SSSS and the automated General Ledger System were finalised for issue to the bidders and approval of the Tender Board for same was obtained during the year under review.

International Accounting Standards and Internal Audit Charter

Improving the financial reporting and accounting practices adopted by the Bank conforming to international best practices is another area, which would improve the CBSL's standard settings vis-a-vis domestic financial institutions in the application of corporate governance best practices. Accordingly, action has been initiated for the following:

- Request for Proposal was forwarded to the five leading international audit firms for the purpose of procuring the services of an international audit firm to carry out a comprehensive audit of the year 2001 accounts in accordance with international accounting standards and to complete other related special assignments.
- Gearing the Management Audit Department to set up specialised units to conduct performance audits and information system audits. The Management Audit Department has adopted an internal audit charter for this purpose.

The completion of the above activities would further improve the management audit function and risk management processes and enhance the Bank's credibility in the international community.

The modernisation process is continuing and has been planned to be completed over a time frame of 3 years.

Accounting and Banking Operations

1. Accounting

a. General

As part of the on-going modernisation programme, the Bank has decided to accept International Accounting Standards (IAS) as the basis of the preparation of the Bank's Financial Statements. As an initial step in progressing towards full IAS compliance status, the financial statements for 2001 (including comparatives) were prepared incorporating certain IAS standards. As a result of the adoption of certain standards, the measurement of some assets and liabilities has changed accordingly. Detailed notes on accounting policies and on financial statements for the year ending on 31 December 2001 are given in section (b).

(i) Total Assets as at 31 December 2000

On the restated basis, total assets amounted to Rs. 246.2 billion compared with Rs. 217.2 billion before the re-statement. The net increase of Rs. 29.0 billion is made up of :

	Rs. billion
IMF related assets	40.0
Foreign Trading Securities	(5.9)
Local Treasury Bills, Bonds and Loans	(6.1)
Gold held	1.1
Other assets	(0.1)
Total	**29.0**

(ii) Total Liabilities as at 31 December 2000

On the restated basis, total liabilities amounted to Rs. 246.2 billion compared with Rs. 217.2 billion before the re-statement. The net increase of Rs. 29.0 billion is made up of:

	Rs.billion
IMF related liabilities	23.8
Local Treasury Bills, Deposits etc.	3.3
Capital and Reserves	5.0
Other liabilities	(3.1)
Total	**29.0**

(iii) Total Assets at 31 December 2001

On the restated basis, total assets amounted to Rs. 290.6 billion compared with Rs. 247.5 billion before the re-statement. The net increase of Rs. 43.1 billion is made up of:

	Rs. billion
IMF related assets	47.2
Foreign Trading Securities	(5.0)
Treasury Bills and Bonds	3.3
Loans to Government	(3.5)
Other assets	1.1
Total	**43.1**

(iv) Total Liabilities as at 31 December 2001

On the restated basis, total liabilities amounted to Rs. 290.6 billion compared with Rs. 247.5 billion before the re-statement. The net increase of Rs. 43.1 billion is made up of:

	Rs.billion
IMF related liabilities	23.8
Local Treasury Bills-(Repo)	2.7
Capital and Reserves	16.6
Total	**43.1**

b. Assets/Liabilities 2001

The total assets and liabilities of the Central Bank stood at Rs. 290.6 billion as at the end of 2001 compared with Rs. 246.2 billion as at the end of 2000, showing an increase of Rs. 44.4 billion or 18.0 per cent during 2001. The increase in the assets of the Bank was reflected in increases in the foreign financial assets (by Rs.43.2 billion) and sundry assets (by Rs. 5.0 billion). However, local financial assets of the Bank decreased by Rs.1.9 billion This is due to the combined effect of a drop in Treasury bills and bonds (reverse repurchase agreements) by Rs 28.5 billion, and an increase in the holding of Treasury bills and bonds by 22.4 billion. Further, government's foreign loans and guarantees also decreased by Rs.1.9 billion.

The increase in the liabilities of the Bank was reflected in increases in foreign financial liabilities (by Rs.15.1 billion), capital and reserves (by Rs.15.9 billion), currency in circulation (by Rs. 3.2 billion), local financial liabilities (by Rs.8.7 billion), and other liabilities (by Rs.3.4 billion). There was, however, a decline in the government foreign loans and guarantees by Rs.1.9 billion.

(i) Assets

Foreign Financial Assets

Foreign financial assets comprised the largest category of assets, accounting for 54 per cent of total assets of the Bank, and recorded an increase of 38.2 per cent in 2001 compared with the level in the previous year. The increase was partly due to the receipt of the first tranche of the Stand By Arrangement (SBA) facility of the IMF (SDR 103.35 or Rs.11.8 billion), net purchases of US dollars by CBSL from the local foreign exchange market to build up external reserves (US dollars 127.0 million or Rs. 11.8 billion), receipt of foreign loans raised by the government (US dollars 100.0 million, or Rs.9.3 billion), receipt of foreign exchange against the Sri Lanka Development Bonds (issued by the Central Bank on behalf of the Government (US dollars 158.0 million or Rs. 14.8 billion) and the receipt of the privatization proceeds (Air Lanka US dollars 25.0 million and Prima US dollars 65.0 million, equivalent to Rs. 8.4 billion). The increase in foreign financial assets in rupee terms was partly due to the increase in the rupee value arising from the depreciation of the rupee against major currencies during the year. The value of the Bank's trading securities (foreign financial assets) increased by 38.9 per cent due to an increase

CENTRAL BANK OF SRI LANKA - BALANCE SHEET AS AT 31 DECEMBER 2001

		Notes	2001 Rs.	2000 Rs.
LIABILITIES				
Foreign Financial Liabilities				
Payables			54,550,633	109,653,232
IMF Related Liabilities		21	69,275,212,836	54,257,930,699
Other Foreign Liabilities			171,927,864	32,944,286
			69,501,691,333	**54,400,528,217**
Local Financial Liabilities				
Treasury Bills & Bonds (Repurchase)			2,715,179,044	1,283,836,262
Deposits	- Government		4,301,021,684	3,152,081,409
	- Govt Agencies		9,346,134	42,422,726
	- Commercial Banks		35,951,929,117	31,804,532,340
	- Other Deposits	22	2,976,154,054	2,517,893,829
Payables			1,670,261,143	146,306,010
			47,623,891,176	**38,947,072,576**
Other Liabilities				
Currency in Circulation		23	76,561,172,429	73,315,890,843
Other Liabilities		24	18,649,970,814	15,214,304,429
			95,211,143,243	**88,530,195,272**
Capital & Reserves		25	64,831,178,985	48,950,693,652
Govt. Foreign Loans & Guarantees			13,459,454,955	15,378,137,529
			290,627,359,692	**246,206,627,246**
ASSETS				
Foreign Financial Assets				
Cash Balances		10	34,996,679,884	17,153,806,696
Trading Securities		11	66,434,843,315	47,848,582,936
Gold		12	6,584,656,648	7,341,031,157
IMF Related Assets		13	47,253,415,109	40,103,198,980
Receivables		14	1,029,652,891	670,401,854
			156,299,247,847	**113,117,021,623**
Local Financial Assets				
Treasury Bills & Bonds		15	59,455,391,934	37,014,563,083
Treasury Bills & Bonds (Reverse Repurchase)			1,968,884,000	30,425,633,110
Loans to Government		16	39,275,047,106	36,317,547,105
Loans to Other Institutions		17	149,532,875	519,719,010
Receivables			3,669,422,034	2,503,923,844
Investments in Financial & Other Institutions		18	973,029,680	576,108,601
			105,491,107,629	**107,357,494,753**
Other Assets				
Sundry Assets		19	7,355,432,940	2,399,178,538
Fixed Assets		20	8,022,116,321	7,954,794,803
			15,377,549,261	**10,353,973,341**
Govt. Foreign Loans & Guarantees			13,459,454,955	15,378,137,529
			290,627,359,692	**246,206,627,246**

PROFIT & LOSS ACCOUNT - 2001

	Notes	Year ended 31 December 2001 Rs.	2000 Rs.
Foreign Currency Income			
Interest Income	1	13,961,091,003	18,694,387,969
Interest Expenses		(10,449,448,352)	(14,641,177,220)
Net Interest Income		**3,511,642,651**	**4,053,210,749**
Net Trading Income	2	1,393,473,628	5,391,107,091
Gain/(Loss) from Unrealised Fair Valuations		1,260,365,318	1,706,244,790
Foreign Currency Operating Income		**6,165,481,597**	**11,150,562,630**
Local Currency Income			
Interest Income	3	12,008,693,018	5,674,112,082
Dividend Income	4	30,008,000	37,089,750
Gain/(Loss) from Unrealised Fair Valuations		453,307,029	(795,566,188)
Miscellaneous Income		128,090,529	98,935,153
Local Currency Operating Income		**12,620,098,576**	**5,014,570,797**
Total Income		**18,785,580,173**	**16,165,133,427**
Operating Expenses			
New Currency Issue Expenses	5	(579,005,800)	(543,803,881)
Bad and Doubtful Debt Expenses	6	(262,574,002)	(169,308,236)
Other Operating Expense	7	(3,038,660,693)	(4,566,551,954)
Net Profit for the Period		**14,905,339,678**	**10,885,469,356**
Appropriations to Reserves		3,905,339,678	6,885,469,356
Balance Transferred to the Consolidated Fund		11,000,000,000	4,000,000,000

Note of the Auditor General

The accounts of the Central Bank for the year ended 31 December 2001 were audited under my direction in pursuance of 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(1) of the Monetary Law Act, No. 58 of 1949.

My report to the Minister of Finance required in terms of Section 42(2) of the Monetary Law Act, will be submitted in due course.

Auditor General's Department
Colombo 7
10 April 2002

S.C. Mayadunne
Auditor General

A.S. Jayawardena
Governor

K. Jeganathan
Actg. Chief Accountant

NOTES TO PROFIT & LOSS ACCOUNT

		2001 Rs.	2000 Rs.
1	**Net Interest Income - Foreign Currency**		
	Interest Income		
	Cash and short term funds	1,779,513,263	1,007,774,907
	Trading securities	12,153,468,120	17,675,939,506
	International Monetary Fund	28,109,620	10,673,556
		13,961,091,003	18,694,387,969
	Interest Expense		
	Foreign Securities	9,623,360,357	13,927,863,728
	International Monetary Fund	621,326,944	366,312,677
	ACU	204,761,051	347,000,815
		10,449,448,352	14,641,177,220
2	**Net Trading Income - Foreign Currency**		
	Foreign Exchange Trading	190,882,957	1,060,319,308
	Gold Trading Income	2,394,338	70,334,135
	Security Trading Profit	1,080,568,852	3,246,014,172
	Exchange gains	119,627,481	1,014,439,476
		1,393,473,628	5,391,107,091
3	**Net Interest Income - Local Currency**		
	Interest Income		
	Trading Securities - Govt Treasury Bills	11,901,855,631	5,056,773,203
	Loans and advances	106,837,387	617,338,879
		12,008,693,018	5,674,112,082
4	**Dividend income - Local Investments**		
	Available-For-Sale securities	30,008,000	37,089,750
		30,008,000	37,089,750
5	**New Currency Issue Expenses**		
	Notes Issue Expenses	331,333,962	269,832,081
	Coins Issue Expenses	247,671,838	273,971,800
		579,005,800	543,803,881

		2001 Rs.	2000 Rs.
6	**Bad & Doubtful Debt Expenses**		
	Loans and advances to customers- Specific credit risk provisions	240,222,952	162,655,386
	Write Off of Unrecoverable Balances	22,351,050	6,652,850
		262,574,002	169,308,236
7	**Operating Expenses**		
	Staff costs (Note 8)	2,333,623,821	4,013,049,229
	Depreciation (Note 9)	216,258,458	158,329,728
	Administrative expenses	488,778,414	395,172,997
		3,038,660,693	4,566,551,954
8	**Staff costs**		
	Wages and salaries etc.	1,366,617,294	1,543,573,762
	Pension costs – defined contribution plans	152,865,009	161,749,419
	Pension costs – defined benefit plans	814,141,518	2,307,726,048
		2,333,623,821	4,013,049,229

('The average number of persons employed by the Bank during the year was 1936 and during the year 2000 was 1998)

		2001 Rs.	2000 Rs.
9	**Depreciations**		
	Office furniture & equipments	14,207,974	8,755,415
	Computer & computer equipments	25,040,014	12,091,925
	Motor vehicles	6,205,764	7,010,043
	Fixtues & Fittings	3,838,576	4,158,267
	Library books	1,832,846	1,758,748
	Automated Equipments	10,351,009	12,938,761
	Buildings	148,499,324	109,670,879
	AS 400 main frame	6,282,952	1,945,690
		216,258,458	158,329,728

NOTES TO BALANCE SHEET

	2001 Rs.	2000 Rs.
FOREIGN FINANCIAL ASSETS		
10 Cash Balances		
Cash Balances	5,244,411,158	12,606,810,462
Foreign Notes & Coins	217,730	125,227
Time Deposits	29,752,050,996	4,546,871,007
	34,996,679,884	17,153,806,696
11 Trading Securities		
Foreign Government Securities	55,517,855,679	28,044,569,489
Foreign Government Treasury Bills	6,365,654,186	-
Foreign Securities - Non Government	4,551,333,450	19,804,013,447
	66,434,843,315	47,848,582,936
12 Gold		
Gold held for Trading	4,970,135,989	5,974,339,574
Gold available for Sale	1,614,520,659	1,366,691,583
	6,584,656,648	7,341,031,157
13 IMF Related Assets		
Special Drawing Rights	77,628,818	29,915,472
IMF Quota	47,175,786,291	40,073,283,508
	47,253,415,109	40,103,198,980
14 Receivables		
Sundry Receivables	13,226,343	670,401,854
World Bank Reimburesement of VRS Expenses	1,016,426,548	-
	1,029,652,891	670,401,854
LOCAL FINANCIAL ASSETS		
15 Treasury Bills and Bonds		
Held for Trading;		
Sri Lanka Govt. Treasury Bills	57,955,391,934	37,014,563,083
Sri Lanka Govt. Treasury Bonds	1,500,000,000	-
Treasury bills and bonds	59,455,391,934	37,014,563,083
16 Loans to Government		
Revolving Credit	30,126,600,000	27,169,100,000
Special Advances	9,148,447,106	9,148,447,105
	39,275,047,106	36,317,547,105
17 Loans to other Institutions		
Finance Companies & approved investments	2,733,094,720	2,863,057,903
Add: Interest Receivable	3,577,712,524	3,176,948,792
Total Receivable	6,310,807,244	6,040,006,695
Less: Interest in Suspense	(3,577,712,524)	(3,176,948,792)
Provision for Bad Debts	(2,583,561,845)	(2,343,338,893)
	149,532,875	519,719,010
18 Investments in Financial & Other Institutions		
Regional Development Banks	910,817,180	524,396,101
Sri Lanka Export Credit Insurance Corp.	20,000,000	20,000,000
Credit Information Bureau	12,462,500	12,462,500
National Development Bank	26,250,000	17,500,000
Duff & Phelps Credit rating Ltd.	3,500,000	1,750,000
	973,029,680	576,108,601

	2001 Rs.	2000 Rs.
19 Sundry Assets		
Differed revenue expenditure - Currency issue	616,927,010	447,904,105
Gold purchased from SL Customs and others	365,960,166	365,960,168
Advances	180,536,251	162,360,513
Bank advances recoverable	1,271,185,376	1,205,432,533
Suspense Debtors	192,772,939	52,626,583
ACU	138,075,600	-
Other	4,589,975,598	164,894,636
	7,355,432,940	2,399,178,538
20 Fixed Assets		
Land & Buildings	7,654,328,834	5,501,642,755
Motor Vehicles	55,851,873	63,090,387
Office Furniture & Equipment	127,871,762	78,798,738
Fixture & Fittings	34,547,185	37,424,392
Computer equipment	75,120,042	36,275,777
AS 400 main frame	25,131,807	7,782,759
Automated equipment	41,404,036	51,755,045
Paintings	3,637,312	2,910,500
Library	3,665,693	3,517,496
Buildings in progress	493,688	2,171,532,865
SWIFT	64,089	64,089
	8,022,116,321	7,954,794,803
FOREIGN FINANCIAL LIABILITIES		
21 IMF Related Liabilities		
Quota increases	23,842,963,693	23,842,963,693
Allocation of SDR	8,087,212,441	6,869,650,352
Loans	19,462,579,468	11,942,497,650
Other accounts	17,882,457,234	11,602,819,004
	69,275,212,836	54,257,930,699
LOCAL FINANCIAL LIABILITIES		
22 Other Deposits		
Provident Fund	88,606,126	1,933,974
Pension Fund	1,381,624,537	2,085,883,323
W & O P Fund	1,083,800,758	3,329,193
President's Fund	19,043,650	125,492,310
Other funds	401,835,597	300,495,066
Compulsory savings fund	1,243,386	759,963
	2,976,154,054	2,517,893,829
23 Currency in Circulation		
Notes	73,465,069,612	70,427,916,466
Coins	3,096,102,817	2,887,974,377
	76,561,172,429	73,315,890,843
24 Other Liabilities		
ACU	9,999,354,335	10,998,357,985
Suspense Creditors	5,040,157,523	428,833,168
Others	3,610,458,956	3,787,113,276
	18,649,970,814	15,214,304,429

25 Capital and Reserves

Capital of the Bank is fixed at Rs. 15 million in terms of section 6 of the Monetary Law Act (MLA)

	2001 Rs.	2000 Rs.
General Reserve	17,775,880,561	17,999,684,020
Building Reserve	4,562,738,859	4,562,738,859
Credit Guarantee Reserve	500,000,000	500,000,000
Medium & Long Term Credit Fund	4,925,000,000	4,925,000,000
Profit & Loss Account	14,905,339,678	—
Surplus	985,000,000	985,000,000
International Revaluation Reserve	19,723,526,260	18,921,498,225
Other Reserves	1,438,693,627	1,041,772,548
	64,816,178,985	48,935,693,652

in the market value of securities and investment in foreign government Treasury bills, particularly during the last quarter of the year 2001.

Local Financial Assets

Local financial assets which account for 36 per cent of total assets of the Bank declined from Rs. 107.4 billion in 2000 to Rs. 105.5 billion in 2001 or by 1.7 per cent, mainly due to the decrease in Treasury bills and bonds (used for reverse repurchase agreements). However, the Treasury bills and bonds held by the Central Bank and loans to government (i.e., revolving credit) increased by Rs.22.4 billion and 3.0 billion, respectively, in 2001.

The holdings of Treasury bills and bonds (used for reverse repurchase agreements) declined by Rs.28.5 billion due to the injection of rupee liquidity into the market through other means such as the purchase of US dollars 158.0 million worth of Sri Lanka Development Bonds, net purchase of US dollars 127 million from the domestic market to build up external reserves, purchases of dollars received on account of privatization proceeds and government foreign currency borrowings, etc. Treasury bills and bonds held by the CBSL increased by Rs.22.4 billion or by 61 per cent mainly due to the purchase of Treasury bills from the primary market to provide liquidity to the government during the last quarter of the year.

(ii) Liabilities

Foreign Financial Liabilities

Foreign financial liabilities account for 24 per cent of the total liabilities of the Bank. The IMF related liabilities in 2001 increased by Rs. 15.0 billion or 28 per cent due to the receipt of the first tranche of the SBA facility from the IMF and the revaluation of foreign currency liabilities.

Local Financial Liabilities

Local financial liabilities, which account for 16 per cent of total liabilities, increased by Rs. 8.7 billion or 22 per cent during the year. The growth of domestic financial liabilities was due to the increase of commercial bank deposits by Rs. 4.1 billion, Treasury bills and bonds (repurchase agreements) by Rs. 1.4 billion, government deposits by Rs. 1.1 billion, other deposits by Rs.0.5 billion and payables by Rs.1.5 billion.

Other liabilities

Other liabilities was the largest category, accounting for 60 per cent of the total liabilities of the Bank. Currency in circulation, which is the major item in the other liabilities, increased by Rs.3.2 billion or 4 per cent from Rs.73.3 billion in 2000 to Rs.76.6 billion in 2001. Capital and reserves increased by Rs.15.9 billion or 32 per cent from Rs.49.0 billion in 2000 to Rs.64.8 billion in 2001. Meanwhile, the government's foreign loans and guarantees decreased by Rs.1.9 billion or 13 per cent from Rs.15.4 billion in 2000 to Rs.13.5 billion in 2001.

c. Income

The total gross income of the Bank for the year 2001 was Rs. 29.2 billion compared with Rs. 30.8 billion in 2000. The major portion of this income, i.e., an increase of 43 per cent, was generated by way of earned interest and profits made from local financial operations of the Bank. Thus, the share of the income from local financial operations in total income increased from 18 per cent in 2000 to 41 per cent in 2001. This was mainly due to an increase in Treasury bill holdings of the Bank from Rs.37.0 billion in 2000 to Rs.59.5 billion in 2001, and relatively higher rates of interest that prevailed during the first half of 2001. The increase in Treasury bill holdings of the Bank took place during the second quarter of the year, particularly in the months of May and June 2001. Another reason for the increase in domestic income was the provision of a large amount of funds to the market by way of reverse repurchase facilities on an overnight basis at high rates, with 23 per cent p.a. being the maximum.

The foreign income (net), after deducting interest expenses on IMF (Rs.621.3 million) and ACU (Rs.204.8 million), for the year amounted to Rs.6.2 billion, showing a decline of its share in the total income from 69 per cent in 2000 to 33 per cent in 2001. The decline was mainly due to a lower level of foreign reserves of the Bank during the year, except in the last quarter. Out of the total foreign income of Rs.6.2 billion, the interest income was Rs. 4.3 billion income from foreign securities amounted to Rs.2.5 billion, while interest income on deposits of currency and gold amounted to Rs.1.8 billion. The trading profits from securities, foreign exchange and gold amounted to Rs.1.1 billion and Rs.191 million, respectively. The other income includes an exchange income of Rs.120 million, and gold trading income of Rs. 2.0 million. Marking to market of foreign securities on IAS basis generated an income of Rs. 1.3 billion.

d. Expenditure

The gross expenditure of the Bank decreased from Rs.20.7 billion in 2000 to Rs.14.3 billion in 2001. Of this decline, administrative expenditure contributed 21 per cent, while interest payments on foreign securities and other payments 79 per cent. After making allocation to reserves, the balance net profit of Rs.11.0 billion was set apart for crediting the Consolidated Fund of the Government in terms of section 39(c) of the Monetary Law Act.

e. Accounting Policies and Notes to the Financial Statements for the year ended 31.12.2001

(i) Basis of Presentation

Since its inception, the Central Bank has prepared its accounts on a historical cost basis and more recently, in conformity with Sri Lanka Accounting Standards. Recognising the need to present the financial statements of the Bank on an improved basis and also to be in line with other central banks, the

Monetary Board approved the adoption of the International Accounting Standards (IAS) as the financial reporting framework for the Central Bank. Accordingly, the Bank moved towards progressively conforming to the IAS in the preparation of its financial statements for the year ended 31 December 2001. In doing so, the accounts for the year 2000 were restated on IAS basis to yield meaningful comparatives for year 2001.

As further detailed below considering the functions of the Bank and the requirements of the Monetary Law Act that significant investments in financial and other institutions do not result in the said institutions becoming Subsidiaries or Associates of the Bank, IAS 22, 27 and 28 were deemed by the Monetary Board to be inapplicable to the Central Bank.

The Bank has not fully implemented the revised IAS 19 (Employees' Benefits related Standard). The Bank is in the process of re-evaluating its retirement benefit policies and schemes and the impact on such schemes brought about by the Voluntary Retirement Scheme which became effective from 1 January 2002. However, provision has been made for pension liabilities based on an Actuarial Valuation carried out by Actuarial Management Consultants (Pvt.) Limited - a correspondent firm of Watson Wyatt Worldwide as at 31 December 1999 for the Central Bank of Sri Lanka Pension Scheme. The valuation is effective for a period of three years from the date of valuation. Provision has also been made for Gratuity Liabilities and other employee benefits as of 31 December 2001. The Board intends to obtain a comprehensive actuarial valuation for all pension schemes during the financial year 2002. The Financial Statements for the year 2001, which partially conform to IAS, have been approved by the Monetary Board of the Bank.

(ii) Accounting/Reporting Currency

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

(iii) Summary of Significant Accounting Policies

The principal accounting policies adopted in the preparation of these Financial Statements are set out below:

Subsidiary and Associate Undertakings

The Monetary Law Act No 58 of 1949 of Sri Lanka specifically prohibits the CBSL from engaging in trade or otherwise having a direct interest in any commercial, industrial or other undertaking or to purchase shares of any other banking institution in its 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 transactions among commercial banks operating in Sri Lanka.

Based on the above requirements, investments are made and held by the Bank with a view to disposing the same in the future. Accordingly, these entities have not been consolidated as subsidiaries or accounted for as investments in associates.

Foreign Currency Transactions

Monetary assets and liabilities in foreign currencies are translated into Rupees at the rates of exchange prevailing at the balance sheet date or at contracted rates.

Foreign currency transactions are accounted for at the exchange rates prevailing at the date of the transactions. Gains and losses resulting from the settlement of such transactions are recognised in the income statement. The net amount of unrealised gains or losses arising from exchange revaluation of assets and liabilities as of the balance sheet date are transferred to the International Reserve Revaluation Account in terms of section 41 of the Monetary Law Act.

Interest Income and Expense

Interest income and expense are recognised in the income statement for all interest bearing instruments on an accrual basis. Interest income includes coupons earned on fixed income investment and trading securities and accrued discount and premium on Treasury bills and other discounted instruments. Interest income is suspended when loans become doubtful of collection, such as when overdue by more than 90 days, or, when the borrower or securities issuer defaults, if earlier than 90 days. Such income is excluded from interest income until received, or written off when there is no longer any realistic prospect of it being recovered.

Trading Securities

Trading securities are securities which were acquired for generating a profit from short-term fluctuations in price, or are securities included in a portfolio in which a pattern of short-tem profit taking exists. The Bank invests in trading securities as a part of its management of the International Reserve. Trading securities are initially recognised at cost and subsequently re-measured at fair value based on quoted bid prices. All related gains and losses are included in net trading income. The net amount of unrealised gains or losses arising from exchange revaluation of assets and liabilities as of the balance sheet date are transferred to the International Reserve Revaluation account in terms of section 41 of the Monetary Law Act. Dividends received are included in dividend income.

Gold

Gold held with foreign counterparties is initially stated at cost and subsequently re-measured at fair value, based on quoted market prices. All related gains and losses are included in net trading income. The net amount of unrealised gains or losses arising from exchange revaluation as of the balance sheet date is transferred to the International Reserve Revaluation Account in terms of section 41 of the Monetary Law Act.

Transactions and Balances with the International Monetary Fund

Transactions and balances with the International Monetary Fund (IMF) are recorded on the basis of International Accounting Standards (IAS) and the guidelines set out by IMF. A summary of the policies followed by the Bank for recording these transactions and balances is as follows:

(i) The quota with the IMF is recorded by the Bank as an asset and the amount payable to IMF for quota increases (IMF Securities Account) as a liability of the Bank.

(ii) The cumulative allocation of SDRs by the IMF is treated as a liability and is revalued as at the balance sheet date using the closing exchange rate.

(iii) Exchange gains or losses arising on revaluation of IMF assets and liabilities are transferred to the International Reserve Revaluation Account in terms of section 41 of the Monetary Law Act.

(iv) The following income or charges pertaining to balances with the IMF are taken to the Income Statement.

1. Charges and interest on borrowings under the Structural Adjustment Facility (SAF) and the Enhanced Structural Adjustment Facility (ESAF);
2. Charges on net cumulative allocation of Special Drawing Rights;
3. Return on holdings of special drawing rights; and
4. Remuneration earned on remunerated reserve tranche position with the IMF.

Sale and Repurchase Agreements and Lending of Securities

Securities sold subject to a linked repurchase agreements ('repos') are retained in the financial statements under Treasury bills and bonds and the counterpart liability is shown as Treasury bills and bonds (Repurchases). Securities purchased under agreements to resell ('reverse repos') are recorded as Treasury bills and bonds (reverse repurchases). The difference between sale and repurchase prices is treated as interest and accrued over the life of repo agreements.

Investment Securities and Receivable

In compliance with IAS 39, the Central Bank classified its investment securities and receivables into the followings two categories: held-to-maturity and available-for-sale assets. Investment securities and receivables with fixed maturity where the Board has both the intent and the ability to hold to maturity are classified as held-to-maturity. Investment securities and receivables intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices are classified as available-for-sale.

Investments securities and receivables are initially recognised at cost. Available-for-sale financial assets are subsequently re-measured at fair value based on quoted bid prices, except for investments in financial and other institutions, which are carried at cost. In 2000, all investment securities were carried at cost or amortised cost, less any provision for impairment.

Held-to-maturity investments are carried at amortised cost, less any provision for impairment. Interest earned whilst holding investment securities is reported as interest income. Dividends receivable are included separately in dividend income when a dividend is declared.

Originated Loans and Provision for Loan Impairment

Loans originated by the Bank by providing money directly to the borrower are categorised as loans originated by the Bank and are carried at amortised cost. All loans and advances are recognised when cash is advanced to borrowers.

A credit risk provision 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 provision is the difference between the carrying amount and the recoverable amount, including the amounts recoverable from guarantees and collateral. When a loan is uncollectable, it is written off against the related provision for impairments or to the income statement; subsequent recoveries are credited to bad and doubtful debt expenses in the income statement. If the amount of the impairment subsequently decreases due to an event occurring after the writing down, the release of the provision is credited to bad and doubtful debt expenses.

Inventories

The total cost incurred during the year on stationery and engineering stores has been charged to the income statement, and no adjustments have been made in respect of closing stocks.

Grants

Grants are recognised at their fair value where there is reasonable assurance that the grant will be received and all attaching conditions, if any, will be complied with. When the grant relates to an expense item, it is recognised as income over the periods necessary to match them to the costs to which it is intended to compensate on a systematic basis. Grants related to assets, including non-monetary grants at fair value, are deducted at arriving at the carrying value of assets.

Property, Plant and Equipment

All property, plant and equipment is stated at historical cost less accumulated depreciation. Depreciation is calculated on the reducing balance method to write down the cost of such assets to their residual values over their estimated useful lives using the rates per annum given below. No depreciation is charged in the year of purchase and a full year's depreciation is charged in the year of disposal.

The following depreciation rates were applied.

Land and artwork collections	Nil
Buildings	2%
Motor Vehicles	10%
Office Furniture and Equipment	10%
Fixtures & Fittings	10%
Computer Equipment	25%
Library Books	33.33%
Automated Equipment	20%
AS400 Main Frame Computer	20%

Cash and Cash Equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than 90 days maturity from the date of acquisition including cash and bank balances in current and deposit accounts, Treasury bills and other eligible bills, amounts due from other banks and trading securities.

Provisions

Provisions are recognized when the Bank has a present legal or constructive obligation as a result of past events.

Employee Benefits

1. *Pension obligations*

   The Bank operates the defined benefits and defined contribution plans set out below, the assets of which are generally held in separate funds.

2. *Defined Benefit Funds- Pension Plans and Gratuity*

   - The Pension Fund is funded by payments from the Bank, taking into account the recommendations of independent, qualified actuaries.
   - The pension costs as of 31.01.2001 have been assessed using the aggregate cost method based on the valuation done by a qualified actuary as of 31.12.1999. The pension fund is valued once every three years. All actuarial gains and losses have been recognised in the income statement.
   - The Widows' and Orphans' Pension Fund and the Widowers' and Orphans' Pension Fund are a contributory pension funds where employees contribute 5 per cent of their basic salary to the applicable pension fund. Any shortfall in the fund, as determined by an actuarial valuation, is funded by the Bank. The pension costs as of 31.12.2001 have been assessed using the aggregate cost method based on the valuation done by qualified actuary as of 31.12.1999. The pension funds are valued once in every three years. All actuarial gains and losses have been recognised in the income statement.

3. *Other post-retirement obligations*

   The Bank provides post-retirement healthcare benefits to its retirees. The entitlement to these benefits is usually based on the employees remaining in service up to retirement age and the completion of a 10 year service period. The costs of these benefits are charged to the income statement and reimbursed, based on the actual claims submitted by retirees.

4. *Voluntary Retirement Scheme(VRS)*

   The Bank offered a VRS to all eligible employees which was effective as of 1 January 2002, under a World Bank loan granted to the Government of Sri Lanka for the restructuring of the Central Bank. A grant was received by the Central Bank of Sri Lanka from the Government, out of the loan, to reimburse 70 per cent of the actual retirement cost under the VRS. The estimated net expenses (total VRS expenditure net of the reimbursement) to the Bank under this scheme has been charged to the income statement as of 31.12.2001. The total expenditure to be paid out is shown as a liability and the total reimbursement due as a receivable in the balance sheet as of 31.12 2001.

Currency

Currency issued by the Central Bank represents a claim on the Bank in favour of the holder. The liability for currency in circulation is recorded at face value in the Balance Sheet.

The cost of printing notes and coins is deferred until the time of issue and is charged to the income statement at the time of issue.

Taxation

The income of the Bank is exempt from tax under section 8 (a) xxii of the Inland Revenue Act, No. 38 of 2000.

f. Risk Management Notes

(i) General

In its financial activities, the Bank is subject to interest rate, credit, foreign currency, liquidity and operating risks. The policies for managing these risks are outlined in the following notes. Senior management is responsible for advising the Governor on the monitoring and management of all risks to which the Bank is exposed.

Comprehensive guidelines prepared by the respective departments control the manner in which the CBSL conducts its local currency, foreign currency reserves management, and foreign exchange dealing operations. These guidelines contain specific provisions designed to minimise the risk associated with each operation by any single individual.

(ii) Interest Rate Risk Management

Interest rate risk is the risk of loss arising from changes in interest rates. The value of the financial instrument as well as its rate of return can change with the movement of interest rates. The Bank has adopted appropriate policies to minimise its exposure to this risk. The Monetary Board and the Investment

Committees have set appropriate duration limits for the investment portfolio. Under these duration limits, certain weights are given for the particular maturities of investments such as 2, 3, 5 and 10 years. A separate division within the International Operations Department deals with the monitoring of the Bank's interest rate risk exposure for foreign exchange reserve management, based on these limits.

(iii) Credit Risk Management

Credit risk is the risk of loss arising from a counter-party being unable to pay the amount in full when the payment is due. Credit risk is appropriately managed by employing the following strategies.

(1) selection of counter-party based on their respective credit ratings;

(2) investment asset based on credit rating of particular issuer and the issue size; and

(3) country limit and counter-party limits placed to control the exposure.

The Central Bank follows a very conservative approach in the determination of assets acceptable for investment. Foreign currency placements are made in approved currencies in government or government guaranteed or supra-national securities with approved counterparties. Geographical exposures are controlled by country limits. Limits are updated periodically, based on new market information. Credit risk in the Bank's portfolio is monitored, reviewed and analysed by the appropriate officials and the exposure is properly controlled.

(iv) Foreign Currency Risk Management

Foreign currency risk is the risk of loss arising from changes in exchange rates. Foreign currency activities result mainly from the Bank's holding of currency assets under its foreign reserves management function. Volatility of the foreign exchange markets may expose the Bank to exchange risk. Currency diversification was introduced to avoid this risk. The Monetary Board and the Investment Committee set percentage holdings of different currencies in its International Reserve. The Bank's intervention in the domestic foreign exchange market is limited to US dollars only. In deciding on the currency allocation, public debt repayments requirements are given due consideration. Accordingly, the Bank holds most major currencies such as US dollars, sterling pounds, Japanese yen and the euro. In order to avoid losses arising from changes in the rates of exchange, compliance with limits established for foreign currency positions is being constantly monitored.

(v) Liquidity Risk Management

Liquidity risk is the risk that the Bank will encounter difficulty in raising funds at short notice to meet its commitments associated with financial instruments. In other words, it is the ability to convert financial assets into cash quickly without a significant price fluctuation. Liquidity risk can also arise when the Bank will have to sell a financial asset quickly at a price much less than its fair value.

In order to reduce the level of liquidity risk arising out of the local currency activities, particularly in open market operations, the Central Bank uses highly liquid marketable instruments such as Treasury bills and Treasury bonds as collateral. It manages the daily liquidity position of the banking system including advancing and withdrawal of funds from the system, using such securities.

Liquidity is a key consideration in determining the composition of the Bank's foreign currency assets as well. This reflects the potential requirement to liquidate foreign reserves for intervention purposes and to settle other commitments such as public debt repayment when the need arises.

Accordingly, there are measures aimed at ensuring quick access to funds. These measures include liquid asset ratios based on the liquidity characteristics of securities held and limits on the minimum and maximum proportion of reserves that may be held in any one currency. These limits are monitored on a daily basis. At the same time, in the case of investments in medium-term securities, the Bank manages this liquidity risk by investing in securities that are known to be liquid at all times. Although this type of investments offer lower returns when compared with more risky investments, the Bank prefers more liquid investments such as AAA rated governments and supra-nationals. The rate of return is enhanced by using other strategies.

2. Banking Operations

a. General

The Banking Department continued to carry out its main functions in the areas of management of the International Reserve of the country, the management of the exchange rate, the implementation of monetary policy measures mainly through open market operations, statutory reserve requirements and the Bank Rate, maintenance of accounts of the government and government agencies, licensed commercial banks, non-bank primary dealers and international organisations and the preparation of the monthly balance sheet and annual accounts of the CBSL.

b. Foreign Exchange Reserve Management

The Banking Department continued to be entrusted with the task of managing the International Reserve with the objective of maximising returns through investment in foreign financial assets, while maintaining a high level of liquidity and minimum risks. Accordingly, a major portion of investments were made in fixed income securities, while the balances were in short-term investments such as fixed deposits, call and current accounts and in the form of gold. US dollars, sterling pounds and euros were the main currencies in which the reserves were held during 2001. The total net foreign income generated through the management of the International Reserve of the country amounted to Rs. 6.1 billion in 2001.

c. Exchange Rate Management

Since 1977, foreign exchange transactions in Sri Lanka were progressively liberalised by permitting foreign exchange dealers (commercial banks) to determine the exchange rate with foreign currencies, depending on the supply of and the demand for foreign currencies in the domestic market. The CBSL participated in the domestic exchange market operations to even-out sharp fluctuations in the daily exchange rates to assist exporters and importers, since such fluctuations would have been harmful to their business.

The CBSL continued to participate in the market by announcing daily buying and selling rates of the US dollar, which was the intervention currency until about the middle of June 2000. The rates were determined on the basis of changes in the value of the US dollar and those of the major currencies in the international markets, as well as local market conditions.

After June 2000, the foreign exchange market was permitted to operate more freely by widening the spread between the buying and the selling rates of the CBSL, which were announced at the beginning of every business day. However, it was observed that this had caused a building up of expectations for a continuous depreciation of the exchange rate of the rupee, contrary to the fundamentals in the market, necessitating increases in local interest rates from time to time to stabilise the exchange rate. With the increased demand for foreign exchange, particularly from the state sector corporations, the market rate continued to depreciate heavily with the rate sometimes moving above CBSL's selling rate. It was, therefore, observed that an exchange rate band was no longer sustainable, particularly in a high demand and speculative environment.

Therefore, the CBSL made a fundamental change to its exchange rate regime with effect from 23.01.2001, by allowing greater freedom for the market forces to determine the US dollars/LKR exchange rate. From that date, the Bank refrained from announcing the buying and selling rates of the US dollars in advance. Instead, CBSL participated actively in buying and selling US dollars at or near market prices. The intervention currency continues to be the US dollar. This new arrangement permitted freer transactions in the market and stabilised the value of the rupee. The objectives of CBSL's presence in the domestic forex market were to accumulate reserves consistent with the outturn of the balance of payments position and to promote the smooth functioning of the foreign exchange market and orderly adjustment of the exchange rate. It also sought to harmonise monetary policy and exchange rate policy which, by helping to ease the high interest rates that prevailed in the market at that time, is expected to contribute to promote investment and longer-term economic growth.

With the independent floating of the exchange rate, the Bank was able to maintain exchange rate stability, while accumulating reserves during the year 2001. While the exchange rate depreciated by 11.4 per cent during 2001, the period after 23.01.2001, saw a depreciation of the rate by 10.0 per cent only. At the same time, the Bank was able to accumulate a considerable amount of foreign exchange to its reserves as shown in Tables II- - 1 and II - 2 below. During 2001, the Bank emerged as a net buyer of foreign exchange in contrast to the net seller position that prevailed in the previous years.

The value of spot and forward foreign exchange contracts bought and sold among Commercial Banks (monthly basis) are given in Table II - 3.

TABLE II - 1

Foreign Exchange Transactions with Commercial Banks in Sri Lanka – 2001

in '000

	Spot Purchases		Spot Sales	
	US$	Rs	US$	Rs
January	-	-	33,498	2,899,892
February	-	-	-	-
March	19,850	1,697,615	1,250	107,820
April	1,550	135,656	-	-
May	-	-	8,715	793,733
June	-	-	-	-
July	10,000	899,510	-	-
August	77,400	6,868,621	-	-
September	36,300	3,272,703	-	-
October	11,500	1,038,315	8,425	499,931
November	3,750	345,790	-	-
December	18,850	1,754,833	-	-
TOTAL	179,200	16,013,043	51,888	4,301,376

TABLE II - 2

Volume of Spot Sales and Purchases of Foreign Exchange by CBSL

US$ million

Year	Sales	Purchases	Net
996	198.0	96.2	- 101.80
1997	154.0	136.7	- 17.30
1998	214.8	61.0	- 153.8
1999	58.2	0.4	- 57.80
2000	303.6	2.0	- 301.6
2001	51.8	179.2	+ 127.40

TABLE II - 3

Inter-bank Foreign Exchange Transactions Volume

US$ million

2001	Amount	
	Spot	Forward
Jan.	128.80	15.625
Feb.	118.00	2.780
March	146.00	21.825
April	91.30	5.150
May	93.40	11.465
June	75.50	17.175
July	120.10	34.325
August	137.80	43.200
Sept.	102.00	40.800
Oct.	92.00	40.475
Nov.	73.00	20.610
Dec.	73.00	28.650
Total	1250.90	282.080

d. Implementation of Monetary Policy

(i) Open Market Operations

During 2001, Open Market Operations (OMO) continued to be the main instrument through which monetary policy was implemented by CBSL. OMO, as in the past years, included outright buying or selling of government securities and, repurchase (Repo) and reverse repurchase (Reverse Repo) transactions. Only government Treasury bills were used as collateral for repurchase transactions. However, for reverse repurchases transactions, both Treasury bills and Treasury bonds were used.

(ii) Outright Transactions in the Secondary Window

The total outright sales (discounting) of Treasury bills in the secondary window of the Central Bank to the participating institutions (PIs), which consisted of 9 Licensed Commercial Banks (LCBs), Primary Dealers (PDs) and CBSL's internally managed funds amounted to Rs. 20.4 billion in 2001, recording an increase of Rs. 4.7 billion (30 per cent) when compared with Rs.15.7 billion in the previous year. The contribution by LCBs and PDs to the total outright sales stood at Rs. 8.6 billion, recording an increase of Rs 2.3 billion (48 per cent of the total increase). Similarly, a total of Rs. 11.7 billion worth of Treasury bills were bought by CBSL's internally managed funds, an increase of Rs. 2.4 billion compared to 2000. The main contributory factor for this development, particularly with regard to LCBs and PDs, was the declining trend in Treasury bill yield rates at the primary market towards the latter part of the year, which enabled PIs to secure a better yield at the CBSL's secondary window. The CBSL's decision in 2000 to physically deliver the Treasury bills to the respective buying parties, providing an opportunity to use them for trading in the market, also made Treasury bills at the CBSL's secondary window more attractive to LCBs and PDs. The monthly volumes of outright sales of Treasury bills at the secondary window of CBSL in 2000 and 2001 are shown in Chart – I.

In line with the developments observed in the yield rates at the Treasury bills primary auctions, CBSL's discounting yield rates on 3-months, 6-months and 12-monthsbills gradually increased from 17.86 per cent, 17.88 per cent and 17.95 per cent per annum, respectively, at the beginning of 2000 to 19.56 per cent, 19.67 per cent and 20.65 per cent per annum, respectively, on 09 April 2001. From 25 April 2001, the rates started to decline, and stood at 12.87 per cent, 13.22 per cent and 13.69 per cent, respectively, at the end of the year.

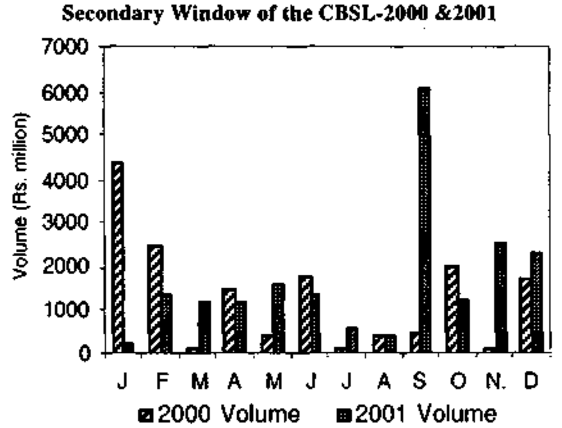
The outright purchases (re-discounting) of Treasury bills by CBSL decreased from Rs.2.1 billion in 2000 to Rs. 645 million in the year 2001, recording a decline of 69 per cent (Rs. 1.5 billion), despite the large and continuous liquidity shortage experienced by the market during the year. The preference of some participating institutions to repo-out their Treasury bills rather than selling outright to the CBSL to meet their long-term liquidity shortages, and declining yields in the Treasury bill primary market, which yielded capital losses if sold outright, were the reasons for the drop in the volume of outright purchases of Treasury bills by the CBSL during the year under review.

CBSL's re-discounting yield rates, which are linked to the Primary Market's Yield Rates (PMYR), moved in line with trends witnessed in the primary market yield rates during 2001. Further, the margin between re-discounting yield rates and the PMYR was reduced from 350 basis points to 125 basis points with effect from 27 December 2001. Accordingly, CBSL's Re-discounting yield rates on Treasury bills of 91-days, 182-days and 364-days decreased from 21.27 per cent, 21.40 per cent and 21.72 per cent, respectively, at the beginning of the year, to 14.17 per cent, 14.52 per cent and 14.99 per cent per annum, respectively, at the end of the year. The monthly volumes of outright purchases of Treasury bills at the secondary window of CBSL in year 2000 and 2001 are shown in the Chart –II.

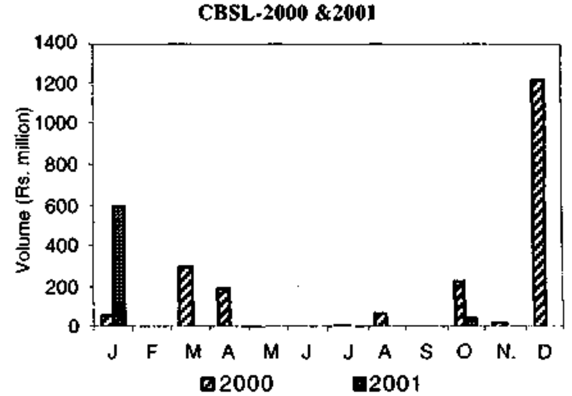
(iii) Repurchase (Repo) transactions

In 2001 too, investments in Treasury bills repurchase agreements were one of the major avenues available for various

CHART–1
Monthly Volumes of Outright Sales of Treasury Bills at the Secondary Window of the CBSL-2000 &2001

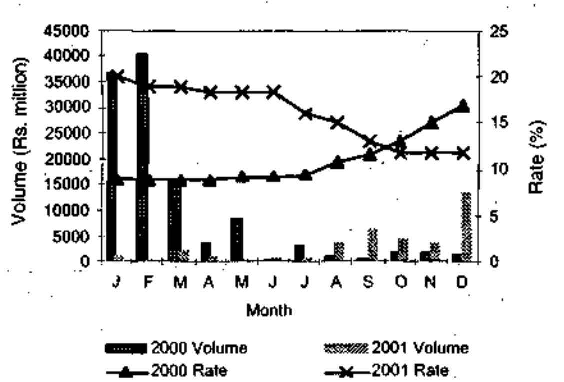


CHART–II
Monthly Volumes of Outright Purchases of Treasury Bills at the Secondary Window of the CBSL-2000 &2001



Funds maintained by CBSL, and LCBs and PDs to invest their excess funds for a short period, ranging from overnight to seven days, which, in turn, helped stabilising the lower end of the inter-bank call money market rate. The total volume of Treasury bills (overnight equivalent) sold under repurchase agreements decreased from Rs. 226.4 billion in 2000 to Rs. 203.0 billion in 2001, or by Rs. 23.5 billion (10.36 per cent). Total investments in repo by LCBs and PDs declined by Rs. 50.2 billion (57 per cent) and Rs. 26.6 billion (95 per cent), respectively, to Rs. 37.2 billion and Rs. 1.3 billion, respectively, in 2001. The decline was sharp during the first half of the year, but sales increased gradually with the improvement in rupee liquidity during the second half. However, investments in repos by various funds managed by CBSL increased from Rs. 111.2 billion in 2000 to Rs. 164.5 billion in 2001. Monthly repo volumes with LCBs and PDs are shown in Chart – III.

CHART–III
Monthly Repo Volumes and Rates 2000 &2001

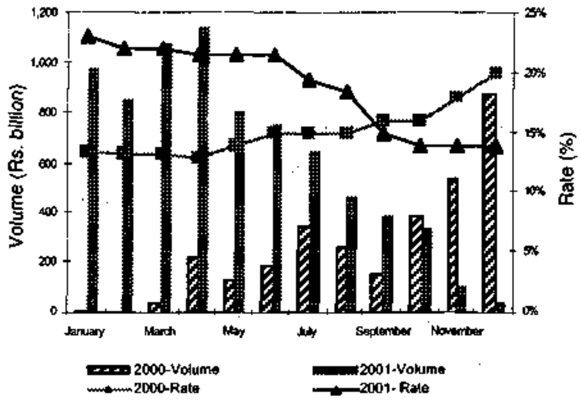


The overnight Repo rate is determined by CBSL taking into consideration the conditions in the financial markets as well as the monetary policy stance of the Bank. The rate was increased to 20 per cent on 18 January 2001. From 26 February 2001, the Repo rate was reduced in six steps to 12 per cent as at end of 2001, with a shaper reduction during the second half.

(iv) Reverse Repurchase (Re-repo) transactions

In 2001 too, reverse repurchase transactions continued to play a major role in providing rupee liquidity to the market, while stabilising the upper end of the inter-bank call money market rate. As the rupee liquidity shortage observed during the previous year further deepened and remained high during most of 2001, the overnight equivalent of total volume of reverse repo at the reverse repurchase window of CBSL recorded a more than two fold increase from Rs. 3,130 billion in 2000 to Rs 7,544 billion in 2001. The monthly reverse repo volumes (overnight equivalent) and rates are shown in Chart – IV.

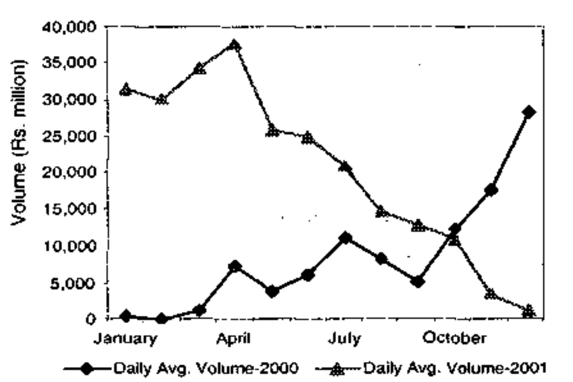
CHART–IV
Reverse Repo Monthly Volumes and Rates 2000 &2001



The reverse repo transactions were conducted only with the LCBs and PDs. The LCBs increased their participation in the reverse repo window by 152 per cent to Rs. 7,244 billion, while PDs raised their participation by 17 per cent to Rs. 298 billion in 2001. In the total reverse repo volume, the two state banks' contribution was the largest, and it increased by Rs. 4,293 billion (173 per cent) to Rs. 6,779 billion in 2001. Government Treasury bonds were the more popular underlying security for reverse repo transactions in 2001. The total value of reverse repo transactions against Treasury bonds as a percentage of total reverse repo volume stood at 95.7 per cent in 2001, compared with 51.3 per cent in 2000.

The daily volumes of reverse repo transactions at the reverse repurchase window (Chart – V) of CBSL increased significantly until April 2001. However, the rupee liquidity in the market gradually improved after April 2001. The liquidity shortage disappeared by December 2001, with purchases by CBSL, of foreign currency funds mobilised by the government through privatisation, issue of Sri Lanka Development Bonds,

CHART–V
Daily Average Volume of Reverse Repo
January through December 2000 &2001



and government foreign currency borrowing and CBSL's purchases of foreign currency in the domestic market, reduction of statutory reserve requirement from 11 per cent to 10 per cent and an injection of rupee funds through the investments in the Treasury bill primary market. Accordingly, as shown in Chart – V, the daily average volume of (overnight equivalent) reverse repo declined gradually towards the year end.

Similar to the Repo rate, the Reverse Repo rate was also determined by the CBSL, taking into consideration financial market conditions and monetary policy consideration. The Reverse Repo rate was increased to 23.00 per cent on 18 January 2001. From 26 February 2001 the Reverse Repo rate was reduced in six steps to 14 per cent as at end of 2001, with a shaper reduction during the second half.

(v) 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, was reduced on two occasions during 2001, i.e., from 25 per cent to 23 per cent per annum on 02 July 2001 and from 23 per cent to 18 per cent on 27 December 2001.

(vi) Statutory Reserve Requirement (SSR)

The SRR against the deposit liabilities of commercial banks denominated in Sri Lanka rupees was reduced from 11 per cent to 10 per cent, with effect from 19 October 2001.

(vii) Medium and Long Term Credit

The Medium and Long Term Credit Fund (MLCF) remained unchanged at Rs.4.9 billion during 2001. The total amount of outstanding credit released to finance companies from MLCF, before provision for bad debts, was Rs. 2.6 billion as at the end of 2001. The amount repaid during the year was Rs.130 million

e. Functions as the Banker to Government and Commercial Banks

(i) Financial Institutions Accounts

Operating as the banker to banks, CBSL continued to provide current account facilities to commercial banks, primary dealers and selected other non-bank financial institutions to ensure an efficient inter-bank payment and settlement system. Initiatives have been taken, with financial assistance from the World Bank, to introduce a Real Time Gross Settlement (RTGS) System for large value fund transfers of the above financial institutions.

(ii) Government Accounts

As banker to the government, the CBSL continued to maintain accounts of government departments, government agencies and institutions and certain statutory boards, providing them with required banking facilities. The total number of such accounts maintained by CBSL stood at 133 as at the end of 2001. Six (06) new accounts were opened during 2001 on behalf of the government.

(iii) Import Duty Rebate to Exporters

CBSL reimbursed on behalf of the government, a total sum of Rs. 249 million to LCBs in 2001 in respect of import duty rebates paid by them to exporters as against a total sum of Rs.241 million reimbursed in 2000.

(iv) Subsidy and Ex-Gratia Payments to Indian Repatriates

The total subsidy payments made on behalf of the government to repatriated estate workers of Indian origin under the Indo-Ceylon Agreement of 1964, amounted to Rs. 95,103 in 2001, compared to Rs.187,259 in 2000. Ex-gratia payments amounted to Rs. 7,425 in 2001 against Rs.18,975 in 2000.

f. Other Specific Services

(i) Foreign Finance

The Banking Department (BKD) continued to handle disbursements and repayments of various foreign loans and grants under foreign funded development projects, namely projects funded by the World Bank, the Asian Development Bank (ADB), the Japan Bank for International Co-operation (JBIC) and the International Fund for Agricultural Development (IFAD). The disbursement of funds under new project loans granted by international organisations and foreign governments was commenced during the year under review. The Banking Department also continued to collect Counterpart Funds under various foreign loans and grants on behalf of the government and invested such funds in Treasury bills on requests made by donor agencies. Further, the Banking Department continued to issue guarantees to various institutions on behalf of the Government of Sri Lanka.

(ii) Compulsory Savings Fund

CBSL continued to be the custodian of monies collected under the Compulsory Savings Act, No. 6 of 1971 and the Ceiling on Income and Compulsory Savings Law, No. 15 of 1972, and continued to administer the Compulsory Savings Fund on behalf of the Government. As at 31 December 2001, there was a balance of Rs.82.3 million in the Fund.

(iii) Re-commencement of the Final Payment against Kuwaiti Dinars Deposited with Commercial Banks

During 2001, CBSL took steps to re-commence the final payment against old Kuwaiti dinars deposited with commercial banks by persons who returned from Kuwait in 1990, after the hostile situation in Kuwait. The CBSL introduced a scheme in October 1990, with the assistance of local commercial banks, to provide immediate relief to such persons in the form of partial encashment of Kuwaiti dinar currency notes that were brought by them.

Subsequently, the Central Bank of Kuwait announced the withdrawal of Kuwaiti dinar currency notes issued and placed in circulation upto 1 August 1990 and the issue of currency notes of the new design against those notes withdrawn. The

Bank also announced that they will not accept certain series of old Kuwaiti dinar currency notes in different denominations in exchange for new currency notes so issued. The final date for the conversion into new design notes of valid old Kuwaiti dinar currency notes, held abroad by individuals and banks was 30.09.1991.

CBSL, with the assistance of the Ministry of Foreign Affairs and commercial banks operating in Kuwait, took steps to repatriate old Kuwaiti dinar currency notes which had been deposited by commercial banks and held by CBSL for conversion into new design Kuwaiti dinar currency notes in accordance with the guidelines given by the Central Bank of Kuwait. The Central Bank of Kuwait, after verification of currency notes forwarded to them by CBSL through its correspondents, informed that a certain portion of the currency notes forwarded to them were of the series invalidated by them and that the proceeds were remitted only against those Kuwaiti dinar currency notes accepted by them for exchange for new design currency notes. Accordingly, CBSL issued necessary instructions to commercial banks to release the balance due to their customers (at Rs.53.84 per dinar) who deposited Kuwaiti dinar currency notes with them on the basis of the total realised value received from the Central Bank of Kuwait.

Later on, CBSL submitted a claim to the United Nations Compensation Commission (UNCC) regarding the Kuwaiti dinar currency notes not accepted by the Central Bank of Kuwait for conversion. UNCC accepted a portion of the claim and proceeds were then remitted to Sri Lanka. Accordingly, CBSL issued necessary instructions to commercial banks to release the funds received, to their customers who deposited Kuwaiti dinar currency notes with them, on the basis of the amount realised/received from the UNCC on a pro-rata basis by end October 2001. On the basis of the realised value for old Kuwaiti dinar currency notes, the rupee amount paid to the depositors was at the rate of Rs. 184.32 per dinar as the final payment. Accordingly, the depositors of Kuwaiti dinars with the commercial banks in 1990 received Rs.238.16 per Kuwaiti dinar in three installments.

(iv) Asian Clearing Union

Trade with ACU Countries in 2001

The total value of the transactions routed through the ACU mechanism increased from Rs. 66.1 billion in 2000 to Rs. 72.4 billion in 2001. The gap between the payments for imports and receipts from exports amounted to Rs. 46.4 billion in 2001. The rupee value of the net settlements made in foreign currency amounted to Rs. 55.1 billion during the year 2001. Sri Lanka's contribution to the SWAP facility provided under the ACU agreement during the period under review was Rs. 573 million.

Meeting of the Board of Directors and Decision Taken

The 30th meeting of the Board of Directors of the Asian Clearing Union was held on 28 May 2001 in Yangon, Myanmar. The Governor of the Central Bank of Sri Lanka was elected as the Chairman of the ACU for the year 2002 and the Board of Directors decided to hold the 31st meeting of the Board of Directors in Colombo in during May 2002.

3. Reconstitution of the Banking Department into four Departments

Under the on going modernisation programme of CBSL, steps were taken during 2001 to reconstitute the Banking Department by distributing its functions among four (4) departments with a view to improving efficiency and performing its operations in line with current international best practices. The four (4) new departments to be established from 1.1.2002 are the International Operations Department, the Domestic Operations Department, the Payments and Settlements Department and the Finance Department.

The International Operations Department will be responsible for strategic and efficient management of the official international reserves, while maintaining exchange market stability. It will perform all functions relating to portfolio management of official foreign exchange reserves and implementation of the exchange rate policy, including the monitoring of activities of the domestic foreign exchange market and liaising with overseas central banks, international organisations and counterparts.

The Domestic Operations Department will be responsible for the implementation of monetary policy measures, while ensuring the stability of the domestic money market. It will conduct open market operations, implement the lender of last resort facility, statutory reserve requirements and monitor developments in the domestic money market and formulate policies and guidelines for development of the domestic money market.

The Payments and Settlements Department will be responsible for ensuring the safety, efficiency, integrity and stability of the payments and settlement system and ensure that it functions in an orderly manner. It will carry out all back office functions of the International Operations and the Domestic Operations Departments and related payments and settlements, and operate a 'Real Time Gross Settlement System' with member banks and institutions to establish an on-line real time, irrevocable payment mechanism among the participants. It will also be responsible for implementing measures to ensure an efficient management of the payment system and the supervision and maintenance of a system of payments and settlement of securities.

The Finance Department will be responsible for efficient budgetary control, and an accounting and internal payment system, in line with international standards. Its functions include the payment of salaries and other payments to staff, preparation and monitoring of the CBSL budget, preparation of the monthly balance sheet and annual accounts of the Bank in line with international accounting standards, maintaining accounts of CBSL retirement benefit funds, managing their investments and payment of benefits and maintaining accounts of various staff benefit schemes.

Box II - 2

Payments System Reforms

The Payments System consists of a set of payment instruments, individuals, financial institutions and service providers, clearing and settlement processes and actual transfer of funds between institutions. The Central Bank (CBSL) plays a key role in the overall functioning of the payments system since it :

(a) owned and operated all three main clearing and settlement systems;
(b) regulates and supervises commercial banks (participants in the systems);
(c) issues and manages public debt for the government.

CBSL is empowered by Section 98 of the Monetary Law Act to provide facilities for clearance of transactions among commercial banks operating in Sri Lanka. Section 98(2) provides for the reserves maintained by commercial banks with CBSL to serve as the basis for clearance of cheques and settlement balances among such banks. Similarly, in terms of Section 112 A(a) of the Monetary Law Act, CBSL provides facilities for non-commercial bank primary dealers to maintain accounts at CBSL for purpose of settling of securities transactions. The main payments and settlements systems operated by CBSL during the year under review were :

(a) CBSL Current Accounts System;
(b) Cheque Clearing Systems operated by the Sri Lanka Automated Clearing House (SLACH);
(c) Sri Lanka Inter-bank Payment System (SLIPS).

Cheques are the most widely used retail payment instrument other than cash. Individuals and corporate sector mainly use cheques drawn on commercial banks. Since the establishment of the SLACH in 1988, the clearing process of cheques has been improved and expedited, while the volume of cheques cleared through the SLACH has increased from 11.7 million in 1988 to 35.3 million in 2001. During the year under review, steps were taken to divest the functions of SLACH in early 2002, permitting the commercial banks to manage it by themselves. Cheques drawn by a commercial bank on its account at CBSL in favour of another bank are mainly paid directly to the drawee's account at CBSL, rather than being presented to the functions of SLACH. The other major non-cash payment instruments are the Sri Lanka Inter-bank Payment System (SLIPS) operated by the SLACH, and credit, debit and ATM cards. The majority of large value payments are settled at the CBSL Current Accounts System and it performs the systemically important end of day settlement system mainly for large value inter-bank and inter-primary dealer payments on transactions in the call market, government debt securities market, foreign exchange market and repurchase/reverse repurchase transactions under Open Market Operations (OMO) of CBSL. Settlements in CBSL's Current Accounts System are done on the basis of end-of-day net settlement of liabilities and claims across participant's current accounts maintained at CBSL.

Each licensed commercial bank (LCB) maintains a current account at CBSL to facilitate payments and settlements obligations and to meet the statutory reserve requirements (SRR). Eight primary dealers also maintain accounts at CBSL to engage in transactions in government securities. The LCBs and the primary dealers are not permitted to overdraw their current accounts at CBSL. They have two means to obtain liquidity to meet their obligations. Firstly, LCBs can use their excess reserve balances maintained in their current accounts. The LCBs are requested to maintain SRR on the basis of a daily average over a week subject to maintaining at least 90 per cent of the requirement on a daily basis. Secondly, they can use the collateralised reverse repo facility under OMO at the interest rate determined by CBSL.

Based on a detailed study by PricewaterhouseCoopers in 1998, CBSL decided to develop the government securities market for effective debt management and to fine–tune CBSL's monetary operations. Accordingly, emphasis was paid to developing and implementing a Scripless Securities Settlement (SSS) System for government debt securities to enhance efficiency of the settlement process of Treasury bills and bonds. With the growing concern of activating the CBSL's OMO, the contribution that a Central Depository System (CDS) could make in enhancing efficiency in securities settlement mechanism was recognised. In 2000, CBSL requested the Commonwealth Secretariat in London to review the policy and business issues relating to the existing clearing and settlement systems for debt securities and other financial market transactions. Following the Commonwealth Secretariat's recommendations, initially, an Internal Payment Council (IPC), was set up in 2000. The IPC was to consider broad policy issues relating to the payments and settlements system including a scripless trading system for debt securities and broader issues relating to the RTGS System.

During the year under review, CBSL's initiative in payment reforms changed significantly as it embarked on the modernisation project funded by the World Bank, Swedish International Development Agency (SIDA) and CBSL. Upgrading of the core financial system infrastructure became an integral component of the overall restructuring of CBSL.

Box (Contd.)

The scope of the reforms includes acquisition, testing and implementation of the following systems :

(a) A Real Time Gross Settlement System (RTGS) which is capable of processing large value and other time critical fund transfers;

(b) A Central Depository of Securities, Registry and Scripless Securities Settlement System for government debt securities and its integration with the RTGS system to facilitate Delivery versus Payment (DvP);

(c) An automated General Ledger System (GLS) to support CBSL's current and future financial operations.

These reforms are expected to:

- Eliminate payments risks inherent in the present end of day settlement system in line with international best practice;
- Establish infrastructure required to support the development of financial markets in Sri Lanka
- Enhance the integrity and tradability of Sri Lanka's public debt;
- Improve the efficiency and quality of CBSL's financial operations and the Securities Settlement System;
- Make available efficient and same – day settlement facilities to customers;
- Promote sound liquidity management;
- Improve efficiency and effectiveness of the implementation of monetary policy;

A foreign consultant company was invited to assist CBSL in the preparation of the bidding documents for the procurement of the RTGS/SSS and GLS Systems. To facilitate the task of the preparation of the bid documents and to implement the RTGS/SSS Systems, CBSL appointed the RTGS Task Force in August, 2001. The technical specifications in the bid documents were extensively reviewed by the user departments of CBSL and the RTGS Task force to ensure that the proposed system would address adequately the current and future payments and settlement requirements of the banking and financial sector. A micro survey was done in the latter part of 2001 to assess the value and volume of traffic that flows through the proposed RTGS/SSS systems.

CBSL adopted a collaborative, consensus building approach to prepare the financial community well in advance to successfully commence operations of the RTGS system as scheduled. The SLIPS Steering Committee, set up in 1992 with representatives of commercial banks, was reconstituted as the Payments Reform Steering Committee with a broader mandate to enhance communication and consultation among bankers on the designing of wider payment reforms and to discuss operational issues relating to payments and settlements systems. Meetings were conducted with officers from senior management, operational levels of commercial banks and primary dealers and fund managers and details of the system architecture were provided to them to obtain their feedback. The RTGS Task Force identified the policy and operational issues that need to be addressed well in advance before the commencement of the awareness programme of CBSL on the proposed system. The awareness and training programmes were held by the RTGS Task Force to provide a clear and comprehensive description of the proposed system to relevant officers at CBSL, commercial banks and primary dealers and had detailed discussions with them in addressing outstanding issues.

During 2001, the technical specifications and the request for proposals for the RTGS/SSS Systems and the Automated General Ledger System for CBSL were completed. The Cabinet Appointed Tender Board approved the bidding documents, which were sent to the World Bank for final approval in December 2001. The procurement of the RTGS/SSS Systems and GLS will be made in accordance with World Bank procurement procedures and the Sri Lanka Government Tender procedures. In the second phase of the project, CBSL is planning to obtain outside technical support for the procurement and implementation of the project. The RTGS/SSS systems are expected to go live during the second quarter of 2003.

The successful implementation of payment reforms requires collection and building up of a database of payments and settlements information and publishing such information to enhance general understanding and awareness of participants, regulators and professionals as well as others who are interested in being informed of the present and future payments developments. Therefore, in consultation with the commercial bank members of the Payments Reform Steering Committee, CBSL initiated the designing of a quarterly Payments Bulletin during the year under review and it will be published in the second quarter of 2002.

Since the establishment of a robust and coherent legal framework is a critical success factor for the operation of the RTGS/SSS systems, the Technical Committee on Legislation and Documentation for RTGS and SSS, formed in the year under review, drafted rules for the RTGS System on lines similar to those in other countries, taking into consideration the core principles for systemically important payments systems. Further, amendments have been proposed to the Monetary Law Act in order to create a sound legal framework to enable CBSL to establish and implement the RTGS/SSS system and to establish a Central Depository for recording ownership of scripless securities of direct participants and their customers.

Currency Issue

The Central Bank, as the sole currency issuing authority in Sri Lanka, continued to perform the function of issuing legal tender currency from its headquarters in Colombo and from its regional offices at Anuradhapura and Matara. The volume of currency notes and coins in circulation by end 2001 stood at Rs.76,561 million, as against Rs.73,316 million at end 2000. Notes in circulation comprised 96 per cent of the total currency in circulation.

The Bank issued a commemorative coin in the denomination of one rupee to mark the 50th Anniversary of the Sri Lanka Air Force celebrated in March 2001. The cupro-nickel coin, encased in an attractive presentation box, was minted in frosted proof condition and sold to the public at Rs.600. The Bank also issued another commemorative coin, in circulation standard, in the denomination of rupees two to mark the 50th Anniversary of the Colombo Plan in July 2001.

Details of all commemorative coins and notes available for sale at the Central Bank together with their selling prices are given in Table II - 4

The automated currency processing system, which was commissioned in 1992, was upgraded in 2001. The upgraded system facilitated the currency processing work of the Currency Department with a smaller staff.

The Department continued to conduct programmes on identification of counterfeit notes for school children, government employees and the general public. These were conducted through public lectures and through the audio-visual media. A special radio programme on the History and Evolution of Currency in Sri Lanka was also conducted.

The coin collecting programme to collect coins received by various religious establishments to augment the stocks in the Bank, which was launched in 2000, was continued in 2001.

The Department was able to collect coins to the value of Rs.25.5 million under this programme. The bulk of these coins would otherwise have accumulated without getting back into circulation. Collection of coins in this way reduces the need for the Central Bank to mint new coins.

The Cash Exchange Counters, which continued to function at the Moors' Islamic Cultural Home (MICH) Building, were shifted to the Central Bank Head Office Building in July 2001. Under the restructuring programme of the Central Bank, the Currency Department made arrangements to outsource some of its functions. Accordingly, the activities of the Cash Exchange Counters were transferred to the Bank of Ceylon with effect from 1 July 2001. The Bank of Ceylon operates cash exchange counters to the public at their Metropolitan Branch and Pettah Branch in Colombo. However, the counter section of the Currency Department continued to perform limited currency operations, including payments for damaged and mutilated notes. The currency operation sections at the Anuradhapura and Matara Regional Offices continued their activities of issuing and receiving currency in their respective regions.

Bank Supervision

The regulatory and supervisory function of the Central Bank relating to banks is carried out by the Bank Supervision Department (BSD), with a view to ensuring the safety and soundness of the banking system and safeguarding the interests

Table II - 4
Commemorative Coins & Notes Available for Sale

	Description	Year of Issue	Face Value (Rs.)	Metal	Selling Price (Rs.)
1	40th Anniversary CBSL (Capsule)	1990	500	Silver	500
2	5th South Asian Games (Pr.Box)	1991	500	12Kt. Gold	600
3	5th South Asian Games (Capsule)	1991	500	12Kt. Gold	500
4	5th South Asian Games (Pr.Box)	1991	100	Silver	200
5	President R Premadasa (Capsule)	1992	1	Cu-Ni	250
6	2300 Mihindu Jayanthi (Pr.Box)	1993	500	Silver	700
7	- do - (Capsule)	1993	500	Silver	500
8	50th Ann. of the UNO (Capsule)	1995	5	Nickel Brass	200
9	50th Ann.of Ind. Sri Lanka (Pr.Box)	1998	5,000	22Kt. Gold	8,000
10	- do - (Pr.Box)	1998	1,000	Silver	1,200
11	- do - (Note Folder)	1998	200	Polymer	400
12	Cricket World Cup 1996 (Pr.Box)	1999	1,000	Silver	1,200
13	50th Ann.of SL Army - Proof (Pr.Box)	1999	1	Ni Plated Steel	400
14	- do - Brilliant Uncirculated (Pr.Box)	1999	1	Ni Plated Steel	150
15	50th Anniversary CBSL (Pr.Box)	2000	1,000	Silver	1,200
16	50th Ann.of SL Navy - Proof (Pr.Box)	2000	1	Cu-Ni	500
17	- do - Brilliant Uncirculated (Pr.Box)	2000	1	Ni Plated Steel	200

of depositors. The regulation and supervision are governed mainly by the Banking Act and the Monetary Law Act. Institutions that are currently under regulation and supervision of the BSD are Licensed Commercial Banks (LCBs) and Licensed Specialised Banks (LSBs), which include the Regional Development Banks established under the Regional Development Banks Act. Regulatory and supervisory activities were carried out by on-site examinations and off-site surveillance of banks. In addition, BSD issues prudential directions and guidelines in respect of banking activities. Apart from these, BSD also administers the Voluntary Deposit Insurance Scheme.

Approvals for New Banks and Bank Branches

During the year 2001, a licence was issued under Section 5 of the Banking Act to establish a locally incorporated bank by the name "NDB Bank Ltd." to carry on business as a commercial bank. The NDB Bank Ltd. commenced its operations in October 2001 and acquired the business of the Sri Lanka branch of the ABN-AMRO Bank NV, which ceased to carry on banking business in Sri Lanka. During the year, approval was also granted for the closure of banking business of the Colombo branch of the Bank of Nova Scotia. The assets and liabilities of this bank were taken over by the Citibank and the Bank of Nova Scotia ceased to operate in Sri Lanka with effect from 14.05.2001. The Department also concluded the work relating to the winding up operations of the Colombo branch of the Societe Generale, the business of which was closed in September 1999. The NDB Housing Bank Ltd., which was granted approval, in principle, in the previous year to function as a specialised bank to provide housing finance, was issued a licence under Section 76C of the Banking Act. The Bank commenced operations in May 2001. The Ceylinco Savings Bank Ltd., which was issued a licence in 2000 also to function as a specialised bank, commenced operations during the year under review. At the end of the year, 25 LCBs and 14 LSBs were in operation.

The Department continued to attend to requests for the opening, closing and relocation of branches made by LCBs and LSBs in terms of the Banking Act. During the year, approval was granted for the opening of 63 new branches and extension offices/units of LCBs and LSBs, and for the closure of a branch of an LSB. The Department also granted approval for the re-location of 37 branches of LCBs and LSBs during the year.

Establishment of a Financial Stability Committee

In line with the Central Bank's commitment to focus on the maintenance of financial system stability as a core function of the Bank, the Monetary Board approved the establishment of a Financial Stability Committee (FSC) consisting of the Deputy Governor in charge of Bank Supervision, the Assistant to the Governor in charge of Bank Supervision, and Heads of the Departments of Bank Supervision, Economic Research, Public Debt, Supervision of Non-Bank Financial Institutions, International Operations, Domestic Operations, and Payments and Settlements.

The objective of the FSC is to strengthen the financial system in the country. The FSC is, therefore, expected to review the strengths and weaknesses of the financial system, monitor financial sector developments, recommend policy measures for developing the financial infrastructure in the country and for regulating and supervising financial institutions, and to enhance public awareness of the status of the financial system.

The Bank Supervision Department has been entrusted with the task of co-ordinating the activities of the FSC.

Corporate Governance in Banks

The National Task Force on Corporate Governance was appointed in May 2001, comprising 16 members, with 5 representatives from the Central Bank and 11 from other financial institutions. The committee is in the process of finalising a code comprising "Principles for Best Practice for Corporate Governance in Banks and Financial Institutions". The work of the committee was coordinated by the BSD.

Prudential Regulations and Directions

The BSD continued to monitor compliance by banks with regulatory requirements introduced from time to time under the provisions of the Banking Act No.30 of 1988 as amended by the Banking (Amendment) Act No.33 of 1995, and with other prudential requirements. These requirements relate to:

i. the maintenance of minimum capital ratios,
ii. the maintenance of minimum liquid assets ratio,
iii. adherence to the single borrower limit,
iv. limits on share ownership in banks,
v. limits on investment by banks in the equity of companies,
vi. classification of non-performing advances, suspension of interest on non-performing advances, and provisioning for bad and doubtful debts,
vii. limits on accommodation granted to directors of banks, their close relations and concerns in which they have a substantial interest,
viii. acquisition and purchase of immovable property by banks,
ix. format for preparation and publication of annual audited financial statements and submission of the same to the Central Bank in a timely manner,
x. publication of unaudited half-yearly accounts and annual audited accounts in the press, and
xi. appointment of auditors of banks from the list of qualified auditors compiled by the Central Bank.

Directions issued under the Banking Act during the year 2001

During the year under review, the following directions, determinations of the Monetary Board, guidelines and other prudential requirements were issued by the BSD:

i. Direction relating to the revision of the maintenance of minimum capital adequacy ratios by LCBs and LSBs was issued on 27 December 2001. Accordingly, the banks were required to maintain a minimum statutory capital ratio equivalent to 10 per cent of risk weighted assets, with core capital constituting not less than 5 per cent from 1 January 2003. The notice issued on 29 November 2000 in this regard requiring the banks to comply with this requirement from 1 January 2002, was repealed.

ii. Determination made by the Monetary Board in terms of Section 86(g) of the Banking Act No.30 of 1988 in respect of the definition of liquid assets. Accordingly, it has been decided that 50 per cent of the investment by an LCB in commercial paper/promissory notes, which are backed by an approved credit line from a licensed bank supporting the issue to the full redemption value or an investment grade rating by a rating agency approved by the Central Bank of Sri Lanka and has a remaining maturity of less than one year be considered as liquid assets from 31.01.2001.

iii. New guidelines on the granting of facilities for the issue of commercial paper and other forms of promissory notes were issued on 05.01.2001 by replacing the previous guidelines in this regard.

iv. Guidelines on customer due diligence – 'Know Your Customer' procedures were issued to the banks on 03.12.2001.

v. In order to promote the public disclosures by the banks, the following requirements were introduced:

   a. LSBs were requested on 15.08.2001 to publish in the newspapers the Financial Statements on an annual basis (audited) and half-yearly basis, in keeping with international standards for greater transparency of banks' operations.

   b. LCBs were requested on 10.09.2001 to include any audit qualifications when they publish the audited financial statements in the newspapers.

   c. Banks were also requested on 20.03.2001 to disclose the basis of the computation of capital adequacy requirement, i.e., whether on a consolidated basis or on a solo basis, as a footnote to the capital adequacy statement, if published in the annual report of the Bank.

vi. Following prudential requirements were issued regarding certain banking operations involving foreign exchange transactions:

   a. Recovery of Accommodation to Exporters dated 22.01.2001, 29.01.2001, 16.02.2001, 30.03.2001 and 05.10.2001. Banks were instructed to recover export credit granted by the banks, only out of export proceeds and charge interest at an enhanced rate, if credit is settled after 90 days from the shipment of particular export order. Subsequently, the credit settlement period was extended to 120 days subject to the judgement and discretion of banks.

   b. Forward Sales and Purchases of Foreign Exchange dated 29.01.2001, 14.02.2001, 19.03.2001 and 16.07.2001. Banks who are authorised dealers in foreign currency were instructed that the forward contracts in foreign currency entered into with customers should be only for the purpose of trade in goods and services and such contracts should be for a period of 180 days. In respect of forward sale contract, a deposit of 50 per cent of the value of the contract in Sri Lanka rupees was required to be retained, and subsequently this was reduced to 25 per cent.

   c. Prepayment of Import Bills dated 29.01.2001 to restrict prepayment of import bills before the due dates. This restriction was subsequently withdrawn on 17.08.2001.

Off-Site Surveillance System

Under the off-site surveillance system, the BSD continued to monitor the financial condition of the LCBs and LSBs on the basis of periodic information provided by the banks concerning their operations. The main returns that banks are required to submit to BSD include the monthly statement of assets and liabilities and liquid assets, quarterly returns on capital adequacy, income and expenses, non-performing advances, lending to directors and investments, and the annual audited financial accounts.

The information gathered is analysed to ascertain the risk exposure of individual banks, and of the banking system as a whole. It also enables to compare the financial standing and performance of individual banks against the peer group and entire banking sector norms. Further, the information helps in identifying significant and unusual changes, and serves as an early warning system to indicate particular banks or areas requiring further investigation and examination. On the basis of such observations, banks are also required to take prompt remedial action on any shortcomings in order to avoid an adverse impact on their operations.

During the year 2001, the BSD initiated action to introduce a new off-site surveillance system in place of the existing system, based on recommendations made by experts sponsored by the Swedish International Development Agency (SIDA).

The BSD continued to arrange monthly meetings, chaired by the Governor, with the Chief Executive Officers of LCBs and LSBs. These meetings served as a forum for exchange of views and to discuss issues relating to banking operations, and helped to build a close relationship between the banks and the Central Bank.

On-Site Examinations

In terms of the provisions of the Monetary Law Act, all banking institutions are subject to statutory examinations, i.e., on-site examinations during each examination period, which, at present is once in two years.

The on-site examinations are mainly focused on examining the quality of assets of banks, arriving at an overall assessment of their financial condition from the information gathered from the books of accounts and records. Examiners of the BSD visit the Head Office and selected branches of each bank, depending on the area coverage and volume of business, to gather necessary information. The BSD has adopted a new approach – risk resource matching, for on-site examinations. Accordingly, the degree of a bank's exposure to varied banking risks such as credit risk, market risk, liquidity risk and operational risks is measured, and resources available are evaluated to ascertain whether the bank could contain such risks to a minimum level. Capital, earnings and management quality are considered as key resources available for risk mitigation. In addition, banks' compliance with statutory requirements, applicable laws and regulations, internal controls as well as other prudential requirements are also examined. During the year under review, the BSD commenced on-site examination of 10 LCBs and 5 LSBs.

New Trends in Bank Supervision

Keeping pace with changes taking place in the local and international arena, the following measures have been initiated by the Central Bank to improve the stability in the financial system in Sri Lanka:

i. Self-assessment in terms of Basle's core principle for banking supervision to identify the strengths and weaknesses in the existing system. The Financial Sector Assessment Programme (FSAP) of the World Bank/IMF also provided a useful input towards this.
ii. Drafting amendments to the Banking Act to further strengthen the supervisory scope.
iii. Formulation of guidelines on corporate governance for banks to foster transparency in banksing activities and to inculcate best practices among them.
iv. The setting up of a Financial Stability Committee with the objective of ensuring financial sector stability in the country.
v. Moving towards risk based supervision which focuses on risk-resource matching in banks.

Administration of the Deposit Insurance Scheme

The BSD continued to administer the Deposit Insurance Scheme which commenced operations in 1987. This is a voluntary deposit insurance scheme open to banking institutions licensed by Central Bank and to co-operative societies registered under the Cooperative Societies Law No.5 of 1972 which carry on banking business. At present, only four Multi-Purpose Co-operative Societies have obtained insurance cover under the scheme in respect of deposits of their rural banks. The premium payable is 3.75 cents for every Rs.100 per quarter, and the amount paid to the Deposit Insurance Fund by way of premia in 2001 was Rs.1.1 million. The fund stood at Rs.124 million as at 31 December 2001, together with Rs.50 million allocated by the Central Bank in 1997. These funds have been invested in Treasury bills.

Supervision of Non-bank Financial Institutions[1]

The Department of Supervision of Non-Bank Financial Institutions continued to carry out its regulatory and supervisory functions in respect of registered finance companies (FCs) with the objective of ensuring that FCs comply with the minimum prudential requirements stipulated by the Central Bank. The Department strove to achieve this objective mainly through off-site surveillance and on-site examinations.

Off-site Surveillance

The Department continued its off-site surveillance of the 25 registered finance companies. In the process, periodical returns submitted by FCs were analysed with a view to ascertaining the financial condition of the FCs and monitoring their compliance with the provisions of the Finance Companies Act and the directions and rules issued under it. Returns obtained from FCs included weekly statements of liquid assets, monthly statements of large advances granted, monthly statements of assets and liabilities, monthly cash flow statements, quarterly statements of non-performing advances and annual audited balance sheets and profit and loss accounts. Directions issued under the Act included minimum capital and liquidity requirements, provisioning for bad and doubtful debts, single borrower limits, limits on equity investments etc.

On-site Examination

The Department conducted on-site examinations of nine FCs during the year. In order to make an appraisal of capital adequacy, asset quality, management efficiency, earnings and liquidity, examiners of the Department assessed information gathered from books of accounts and other records maintained by FCs. In addition, discussions were held with officers of the companies concerned. Internal controls and systems and the companies' compliance with statutory requirements were also examined.

Meanwhile, spot examinations were conducted of the other sixteen companies prior to the issue of annual licences for 2002. These examinations covered selected critical areas.

[1] Consolidated Balance Sheets of Registered Finance Companies for the years 1992-2001 are given in Appendix Table 113

Implementation of Finance Leasing Act

The Finance Leasing Act No.56 of 2000, which was passed in Parliament on 18 August 2000 to regulate the finance leasing industry, came into operation on 1 August 2001, the date was set by the Minister of Finance and Planning. Regulations with regard to minimum paid up capital, application fees and annual registration fees for an establishment engaged in finance leasing were made by the Minister and was published in the Gazette (Extraordinary) No.1196/27 of 10 August 2001.

The Finance Leasing Act provides for mandatory registration of establishments carrying on finance leasing business. It also provides for finance leasing establishments to be regulated by the Central Bank. The Department of Supervision of Non-Bank Financial Institutions is entrusted with the tasks of registering and monitoring of finance leasing establishments.

In terms of the provisions of the Act, a certificate of registration would be required to carry on finance leasing business. However, any establishment engaged in finance leasing business on the appointed date is allowed to continue to carry on such business without registration for a period not exceeding one year from the appointed date. Hence, such establishments are required to obtain a certificate of registration within that period, if they are to continue to engage in finance leasing business.

Directions/Rules issued under the Finance Companies Act

The following directions and rules were issued by the Monetary Board during the year:

1. Finance Companies Deposit (Amendment) Direction No.1 of 2001
   This amendment, effective from 7 March 2001, provides FCs to accept deposits up to 5 years. Prior to the amendment, they were permitted to accept deposits only up to a maximum period of 4 years. The new measure facilitates finance companies to reduce the maturity mismatch between deposits and advances given for relatively long periods.
2. Finance Companies Lending (Amendment) Direction No.2 of 2001
   The Finance Companies (Lending) Direction No.8 of 1991 restricts granting of loans by a FC to its subsidiaries and associate companies. Under the amended direction which came into effect on 7 March 2001, a FC could grant loans to its subsidiaries, associates and connected companies, subject to a limit of 15 per cent of its capital funds, and on terms and conditions similar to those on which loans are granted to other borrowers.
3. Finance Companies Investment (Amendment) Direction No.3 of 2001
   The Finance Companies Investment Direction No.12 of 1991 had not imposed a limit on aggregate share investments made by a FC, provided that investments in a single company did not exceed 5 per cent of the total capital funds of the FC as at the last audited balance sheet date, and also did not exceed 40 per cent of the issued and paid up capital of the investee company. In terms of the amended direction, which came into effect on 7 March 2001, the total share investments by a FC in other companies should not exceed 25 per cent of the total capital funds of the investing FC.
4. Finance Companies Liquid Assets (Amendment) Direction No.4 of 2001
   The Finance Companies (Liquid Assets) Direction No.7 of 1991 required FCs to invest a part of their liquid assets in Treasury bills, Sri Lanka Government Securities and Central Bank securities and to lodge the documents of title to such securities with the Central Bank. The amendment, effective from 7 March 2001, dispensed with the requirement that the documents of title should be lodged with the Central Bank. FCs could now lodge these documents with any commercial bank.
5. Finance Companies (Deposit Incentive Schemes) Direction No.5 of 2001
   This Direction became effective from 25 May 2001. In terms of this Direction, FCs are required to obtain approval before implementing incentive schemes for deposits. An incentive scheme is an arrangement to confer a monetary or material benefit on the depositors other than by way of interest.
6. Finance Companies (Advertising) Rule No.1 of 2001
   This Rule, effective from 25 May 2001, dispenses with the requirement that FCs should obtain the prior approval of the Governor of the Central Bank of Sri Lanka for advertisements soliciting public deposits.
7. Finance Companies (Interest) Direction No.6 of 2001
   This Direction, effective from 30 August 2001, prescribes a formula by which limits on interest rates payable by finance companies on deposits and other instruments are linked to the weighted average yield on 364-day Treasury bills.

Violation of Directions

During the year, an order was made by the Magistrate Court, Fort imposing a fine of Rs.1 million in a case filed against a director of a finance company for not maintaining the required amount of liquid assets against deposit liabilities. The Court also ordered that the accused would be liable to rigorous imprisonment for a period of one year if he failed to pay the fine.

Failed Finance Companies

Of the nine failed finance companies the administration and management of which were vested in the Monetary Board under the provisions of the Finance Companies Act No. 78 of 1988, four were under liquidation at the end of 2001. The administration and management of the remaining five companies continued to be vested in the Monetary Board. The petition for liquidation is pending in Courts with respect to one such company.

Of the five companies which continued to be vested in the Monetary Board, three continued making relief payments to depositors during the year. One such company was making an enhanced relief payment of 15 per cent of the balance capital outstanding, while the other company was making full payment of the capital. A third company continued to make full payment of capital with interest up to a specified date, to all the depositors. These relief payments were made out of funds received from the Central Bank of Sri Lanka, which had been disbursed to these companies during previous years as refinance loans, proceeds realised from the sale of company assets and through loan recoveries, and dividend income received. No payments were made to depositors by the other two companies during the year, since one company had exhausted the funds, while liquidation proceedings had commenced in respect of the other, which prevented any further repayments being made to depositors. One of the companies to which refinance loans had been granted, repaid Rs.71 million to the Central Bank during the year.

Development Finance

The Development Finance Department (DFD) performs the functions of providing refinance out of loan proceeds from external lines of credit to participating credit institutions (PCII) for financing small and medium enterprises (SMEs), issuing credit guarantees on loans to such enterprises, collecting guarantee premia and administering credit guarantee funds, and undertaking post credit inspection and follow-up action to ensure proper utilisation of loan funds, with a view to preventing defaults.

In 2001, DFD continued to provide refinance facilities by using Asian Development Bank (ADB) and Japan Bank for International Co-operation (JBIC) credit lines for plantation sector development and low-income housing sector development projects. The Plantation Sector Reform Project (PSRP), which commenced operations in May 1996 as a five-year project, concluded in August 2001. The Urban Development and Low Income Housing Sector Project (UDLIHSP), which commenced operations in March 1999, continued to grant financial assistance in 2001.

The issue of credit guarantee covers by the Department under the Small and Medium Term Assistance Project (SMAP) was concluded in January 2001. The Department continued to conduct project inspections and follow-up work in respect of the other credit schemes during the year.

Department officials participated in two important working committees appointed by the Ministry of Industries and Constitutional Affairs (Working Committee on Establishment of Small and Medium Industrial Company (SMIDEC) and Presidential Task Force on Small and Medium Scale Enterprises) during the year.

The Department ceased to function with effect from 31 December 2001 when its functions together with the functions of the Rural Credit Department were transferred to the newly established Regional Development Department (RDD) with effect from 01 January 2002.

Current Credit Schemes

Plantation Sector Reform Project (PSRP)

The PSRP, which commenced in November 1996 as a five-year project, was concluded in August 2001. During the project period, total refinance approvals of the project were Rs.6,475 million, while total disbursements of the project were Rs.4,928 million. In 2001, while Rs.87 million worth of refinance was approved, Rs.251 million was disbursed. Approved loans amounting to Rs.1,347 million had to be cancelled due to insufficient refinance funds in the project. However, to meet the funds requirements of Regional Plantation Companies (RPCs), the CBSL established the Plantation Sector Revolving Fund in July 2001 by using recoveries of loans and interest proceeds of the above project. Seven RPCs that were privatised in 1998 are eligible for funding from the newly created revolving fund.

As in the previous years, the largest portion of the loans, to the value of Rs.48 million, was approved for tree crop development. Disbursement of funds for this category during 2001 was Rs.190 million, which included a part of refinance approved in 2000. Total disbursement under this sub category was Rs.2,918 million (59 per cent) during the project period 1996-2001. Under the sub category of processing, improvement and pollution control, Rs.38 million was approved as refinance in 2001, while Rs.51 million was disbursed. The total disbursement for this sub category during the project period was Rs.1,365 million (28 per cent). Similarly, under the sub category of purchasing of service vehicles, equipment and mini hydro-project, Rs.2 million was approved as refinance in 2001, while the amount disbursed was Rs.10 million. During the project period, total disbursement in this sub category was Rs.645 million (13 per cent). Details of refinance approvals and disbursements are given in Table II - 5.

Among the PCIs in the Project, DFCC Bank (DFCC) accounted for 46 per cent of the total disbursements to RPCs (Rs.115 million) during 2001. National Development Bank (NDB), Sampath Bank, Bank of Ceylon (BOC) and Commercial Bank of Ceylon (CBC) accounted for disbursements of Rs.89 million (35 per cent), 20 million (8 per cent) 17 million (7 per cent) and 10 million (4 per cent), respectively. During the project period, NDB, DFCC, BOC, Seylan, CBC, Sampath and Hatton National Bank (HNB) had disbursed Rs.1,834 million (37 per cent), Rs.1,527 million (31 per cent), Rs.628 million (13 per cent), Rs.388 million (8 per cent), Rs.382 million (7 per cent), Rs.118 million (2 per cent)

TABLE II – 5

Plantation Sector Reform Project Refinance Approvals and Disbursements by Purpose

Rs. million

Purpose	2000		2001		1996-2001	
	A	D	A	D	A	D
Tree Crop Development	908.2	947.0	47.7	189.8	3,248.9	2,918.4
Processing and Improvement	220.7	271.4	37.5	50.9	2,153.5	1,365.0
Service Vehicles and Equipments	84.1	81.7	2.0	10.0	1,072.7	644.6
Total	1,213.0	1,300.1	87.3	250.7	6,475.2	4,928.0

Note: A = Approvals
D = Disbursements

Source : Central Bank of Sri Lanka

and Rs.50 million (1 per cent), respectively. As at end 2001, total recovery of the PSRP was Rs.24 million. Approvals and disbursements of loan funds under the PSRP loan scheme by each PCI and details of credit guarantee liability are given in Table II - 6.

The total liability of the CBSL on account of credit guarantee cover issued against loan disbursements under PSRP was Rs.144 million in 2001. The total liability of the Bank on account of issue of guarantees under this scheme from 1996 to 2001 amounted to Rs.3,038 million. Premia collected on credit guarantees under PSRP amounted to Rs.73 million in 2001, whereas the total premia collected for the period 1996 to 2001 amounted to Rs.195 million.

Urban Development & Low Income Housing Sector Project (UDLIHSP)

The UDLIHSP commenced operations during the first half of 1999 with financial assistance from a loan of US dollars 20 million from the ADB. Refinance approvals and disbursement of loan funds increased rapidly during 2001 in comparison to low disbursements observed in 2000. At the initial stage of the scheme only two PCIs, out of seven PCIs envisaged in the project, were included as PCIs by the ADB. As a result, the progress of disbursements was slow. However, with the inclusion of the other five PCIs, namely, Kandurata Development Bank (KDB), Rajarata Development Bank (RDB), Housing Development Finance Corporation (HDFC), Ruhuna Development Bank (RHDB), and NDB Housing Bank, loan disbursements increased rapidly.

Details of refinance approvals and loan disbursements by financial institutions are given in Table II - 7. Rs.529 million was disbursed during the year under review, and the total refinance approvals stood at Rs.515 million due to the release of refinance against the approvals made in 2000. The HDFC accounted for Rs.347 million and Rs.406 million of refinance approvals and refinance disbursements, respectively.

Out of the total loans granted to sub borrowers, about 66 per cent were for the purpose of construction of new houses and extensions to existing houses. A purpose-wise classification of loan disbursements is given in Table II - 8. This includes the refinance amount and the contributions by the PCIs.

Credit Guarantee Schemes Under Small and Medium Scale Enterprises (SMI and SMAP)

Implementation of Credit Guarantee Schemes of SMI (SMI I, II, III & IV) and of the Small and Medium Enterprise Assistance Project (SMAP) have been successfully concluded. A summary of the performance of the concluded Credit Guarantee Schemes is given in Table II - 9. Loans granted under the SMI were refinanced by the NDB from the proceeds of a line of credit amounting to US dollars 12.6 million provided by the International Development Association (IDA) and the International Bank for Reconstruction and Development (IBRD). Refinance facilities under SMAP were also provided by NDB with the rupee proceeds of loans amounting to US dollars 55 million jointly raised from foreign banks and ADB.

Issue of credit guarantee covers under the SMAP Credit Guarantee Scheme ended in January 2001. The number of

TABLE II – 6

Plantation Sector Reform Project
Refinance Approvals, Disbursements and Central Bank's Credit Guarantee Liability

Rs. million

PCI	2000				2001				1996 – 2001			
	A	D	GL	PC	A	D	GL	PC	A	D	GL	PC
NDB	207.7	145.6	90.5	25.6	-	88.7	55.8	27.0	2,329.4	1,834.2	1,111.2	81.7
DFCCB	345.5	362.3	267.2	17.8	28.0	114.6	54.7	22.6	2,096.4	1,527.4	917.3	55.1
BOC	210.8	207.8	144.7	8.0	-	17.3	15.3	0.3	726.6	627.7	405.1	29.3
SEYLAN	296.7	368.1	265.2	0.8	19.7	19.7	14.5	5.7	502.1	387.8	256.5	6.5
CBC	36.9	72.9	67.5	4.9	-	10.4	4.0	5.6	492.9	382.3	244.6	16.2
SAMPATH	65.7	93.7	32.9	3.0	39.6	-	-	1.8	277.9	118.8	68.8	5.0
HNB	49.9	49.9	34.9	-	-	-	-	0.8	49.9	49.9	34.9	0.8
TOTAL	1,213.1	1,300.2	902.7	60.2	87.3	250.7	144.3	63.8	6,475.2	4,928.0	3,038.4	194.7

A = Approvals
D = Disbursements
GL = Central Bank's Credit Guarantee Liability
PC = Premia Collections

Source: Central Bank of Sri Lanka

TABLE II–7

Urban Developmernt & Low Income Housing Sector Project (UDLIHSP)
Approval of Refinance & Disbursements as at 31.12.2001

Rs. million

PCI	No of Loans Approved		Refinance Amount		Disbursement Amount	
	2000	2001	2000	2001	2000	2001
CBC	63	95	5.1	9.9	4.4	9.4
HNB	78	74	4.9	5.0	2.4	2.4
RDB	190	336	5.2	13.6	-	18.7
KDB	369	1,877	16.5	89.6	6.0	55.9
RHDB		1,395	-	48.0	-	36.4
NDBH		11	-	1.6	-	0.6
HDFC	871	3,683	85.5	347.1	22.6	405.9
TOTAL	1,571	7,471	117.2	514.8	35.4	529.3

Source : Central Bank of Sri Lanka

TABLE II–8

Loan by Purpose (01.01.2001-31.12.2001)

Purpose	No of loans	Loan Amount (Rs. Mn.)
Land Acquisition	758	94.3
Infrastructure Development	102	3.8
New House Construction & Extension	4,430	426.6
Improvements to existing House	2,174	117.7
Purchasing Houses	7	1.1
Total	7,471	643.5

credit guarantee covers issued from 1997 to 2001 was 1,894, while the total loan amount was Rs.2,742 million. Central Bank liability on that amount is Rs.1,271 million. The industry-wise classification of loans granted under the SMAP Credit Guarantee Scheme is give in Table II - 10.

Premia collection on loans for which credit guarantee covers are still in force continued in 2001. Project inspection work and follow up work in respect of non-performing loans granted under both schemes are being carried out by the Department, and settlement of claims submitted by PCIs on non-performing loans continued in 2001.

TABLE II–9

Summary of Performance of Central Bank's SMI Credit Guarantee Schemes as at 31.12.2001

Rs. million

Item	SMI-I (a)		SMI-II (b)		SMI-III (c)		SMI-IV (d)		SMAP (e)	
	No.	Value	No.	Value	No.	Value	No.	Value	No.	Value
1.1 Loans Granted	1670	286.1	2531	1396.5	3130	1955.6	9072	7666.4	1894	2741.6
1.2 Loans Guaranteed	1670	157.5	2531	713.6	3130	1312.6	9072	477.1	1894	1995.6
2.1 Loans Fully repaid (f)	1235	210.0	1754	1130.4	1969	1153.3	7232	5337.6	275	260.7
2.2 Guarantee Withdrawn or Lapsed (f)	113	65.0	534	139.0	940	665.8	291	261.0	53	93.6
3.1 Total Claims Received	338	76.0	228	119.0	171	98.0	291	261.0	58	96.5
3.2 Central Bank Liability on Claim Received	-	34.0	-	66.0	-	67.0	-	177.0	-	54.5
3.3 Settlement of Claims- Fully Settled	232	19.0	126	32.0	92	24.0	96	39.8	12	10.0
Partly Settled	27	2.0	5	1.0	-	-	-	-	-	-
Claim Rejected	32	7.0	46	13.0	44	16.0	57	24.8	1	0.3
Claim Returned	-	-	1	0.2	-	-	11	7.0	4	2.0
Loans fully paid after Submission of Claims	36	2.0	7	2.0	10	4.0	26	13.9	-	-
Claims Deferred	8	2	21	8.0	6	5.0	11	7.0	2	1.0
Claims Pending	-	-	10	3.0	12	8.0	83	65.8	38	38.1
Claims Withdrawn	3	1.0	12	4.0	7	4.0	7	7.0	1	1.4
4.1 Loans Outstanding (f)(g)			15	4.4	50	38.5	1170	1666.9	1537	2340.3
4.2 Central Bank Liability on Loans Outstanding			15	2.1	50	10.0	1170	443.9	1537	780.1
5. Premia Collected		12.2		29.9		46.3		174.6		37.1
6. Post Claim Recoveries	-	10	-	19.2	-	18.4		12.1	-	-

Notes : (a) SMI-I – Operated from 1979-81
(b) SMI-II – Operated from 1982-89
(c) SMI-III – Operated from 1988-91
(d) SMI-IV – Operated from 1992-97
(e) SMAP – Commenced in 1997
(f) Adjusted figures
(g) Provisional

Source : Central Bank of Sri Lanka

TABLE II –10

SMAP Credit Guarantee Scheme
Industry-wise Classification of Loans (a) as at 31 December 2001

Rs. million

Industry Category	No. of Loans Granted			Loan Amount			CBSL Liability
	2000	2001	1997–2001	2000	2001	1997–2001	1997–2001
Food Beverages & Tobacco	58	—	267	130.4	-	481.4	229.7
Textiles Wearing Apparel & Leather Products	10	—	94	34.9	-	174.3	80.3
Wood & Wood Products	7		59	5.9	-	68.9	37.6
Paper & paper Products	8	—	42	21.4	-	113.5	44.6
Chemical, Petroleum, Rubber & Plastic Products	14	—	63	67.2	-	155.6	83.0
Basic Metal Products	16	—	52	9.0	-	56.9	24.7
Non Metalic Mineral Products	—	—	76	—	-	91.0	53.5
Fabricated Metal Products, Machinery & Transport equipment			28		-	21.9	17.2
Agro-Industries	28		200	63.4	-	307.1	178.4
Others(a)	228	5	1,013	352.8	6.5	2,741.6	1,246.6
Total	369	5	1,894	685.0	6.5	4,212.2	1,995.6

(a) Includes passenger and commercial transport, service & filling stations, restaurants, electronic and other services.

Source : Central Bank of Sri Lanka

Investment of Credit Guarantee Funds

The total value of investments in Treasury bills amounted to Rs.2,735 million during the year. The total interest income from the investments amounted to Rs.246 million. Funds for these investments are derived from premia collected under SMI, BPL, SMAP and the PSRP credit guarantee schemes and funds advanced by the CBSL.

Rural Credit

During the year under review, the Rural Credit Department (RCD) continued to implement credit components of several development projects. Many of these credit schemes were either funded by donor agencies or operated with interest subsidies from the government. A few credit schemes were formulated and implemented using revolving funds of previously concluded projects. As the executing agency of the projects/ credit schemes, the RCD continued to be involved in the admission of new Participating Financial Institutions (PFIs), disbursement of refinance to PFIs in respect of loans granted under the projects, and in monitoring and co-ordinating the loan schemes with the assistance of project offices and other relevant agencies. The Department vigorously promoted the Forward Sales Contract Scheme for agricultural products of small farmers. In addition, the Department continued with the administration, loan recovery, premium collections and credit guarantee payment activities in respect of previously concluded projects. During the year under review, the Department successfully completed the implementation of the Urban Environmental Infrastructure Development Project with full utilisation of the allocated funds. The department was also responsible for the activities of the Bank's Regional Offices. The Rural Credit Department ceased to function with effect from 31.12.2001 and its responsibilities were taken over by the newly established Regional Development Department from 01.01.2002.

The credit schemes of the following projects were implemented by the RCD during 2001.

(a) ADB[1] Funded Projects: -

1. Tea Development Project
2. Second Perennial Crops Development Project
3. Skills Development Project
4. North Central Province Rural Development Project.

(b) IFAD[2] /CIDA[3] /SIDA[4] /Japanese Govt.[5] /WFP[6]/ USAID[7]/JBIC[8] Funded Projects: -

1. North Central Province Participatory Rural Development Project (IFAD, SIDA & WFP)
2. Urban Environmental Infrastructure Development Project (USAID)
3. Food and Nutrition Promotion Credit Scheme (Japanese Govt.)

1 Asian Development Bank
2 International Fund for Agricultural Development
3 Canadian International Development Agency
4 Swedish International Development Agency
5 Japanese Food Production Grant
6 World Food Programme
7 United States Agency for International Development
8 Japan Bank for International Co-operation

4. Poverty Alleviation Micro finance Project (JBIC)
5. Matale Regional Economic Advancement Project (IFAD).

(c) Government Funded Projects or Projects Implemented with Government's Interest Subsidy and Projects Implemented with Revolving Funds : -

1. New Comprehensive Rural Credit Scheme including Forward Sales Contract System (NCRCS);
2. Small Farmers and the Landless Credit Project (ISURU);
3. Kegalle District Integrated Rural Development (Revolving Fund) Project;
4. Surathura Programme-Self-employment Promotion through Micro Enterprise Credit; and
5. Southern Province Rural Development (Revolving Fund) Project.

Tea Development Project (TDP)

The TDP, funded by the ADB, is a follow up Project of the Small Holder Tea Development Project (SHTDP). The Project completed its second year of operations in 2001. The project covers all tea growing districts and is scheduled to be completed by 2005. The broad objectives of the project are to increase tea small holders' income on a sustainable basis and to improve the natural environment in the project area. The project consists of four major components, namely; (a) institutional reforms and strengthening; (b) tea development; (c) social infrastructure and afforestation; and (d) project management.

The credit component of the TDP amounted to SDR 15.4 million (approximately Rs.1,650 million). The Bank is mainly responsible for refinancing sub loans granted by PFIs to the sub borrowers. The activities eligible for loans under the project are replanting of tea, establishment of tea nurseries, rehabilitation and modernisation of tea factories, purchase of vehicles and construction of green leaf collection centres.

In 2001, ADB approval was obtained for the inclusion of two new PFIs namely; Lanka Orix Leasing Company Ltd. (LOLC) and Ruhuna Development Bank (RDB) under the project, thereby increasing the number of PFIs to nine. Under the credit component, loans to the value of Rs.1,314.5 million had been approved for 1,776 eligible sub projects and Rs.1,044.5 million had been disbursed to 1,611 sub projects by all PFIs as at the end of 2001. As a result of the increase in prices in the world tea markets, the borrowers were encouraged to invest more in the industry and the PFIs were able to disburse loans exceeding the targets set for the year. Accordingly, the PFIs disbursed a total sum of Rs.672.2 million in 2001, which amounted to 230 per cent of the target for disbursements during the year, i.e., Rs. 293 million. As in the previous year, a majority of the loans had been granted for rehabilitation of bought leaf factories. During the year, ADB approved another special loan scheme for upgrading the bought leaf factories to 5"S" standard (A productivity measurement standard) under the Factory Development Component.

The performance of PFIs shows that DFCC Bank (DFCC) accounted for (32.1 per cent) of the total loan disbursements in 2001. The Bank of Ceylon (BOC) (21.0 per cent), the National Development Bank (NDB) (16.9 per cent), the Hatton National Bank (HNB) (13.3 per cent), the Sampath Bank (10.3 per cent) and the Commercial Bank (COB)(5.6 per cent) were the other major contributors in the disbursement of the balance amount. Upto the end of 2001, the Central Bank had granted refinance amounting to Rs.691.4 million for 897 sub loans released by the PFIs.

Second Perennial Crops Development Project

The ADB funded Second Perennial Crops Development Project which is implemented with the objective of supporting the development and commercialisation of the perennial crop sector by providing credit facilities and support services, completed its 3rd year of operations in 2001. The Project consists of five components, namely Credit, Farm Advisory, Marketing and Technical Services, Research, Seed and Planting Materials, and Institutional Strengthening. The Central Bank implements the credit component of the Project, and the Project Management Office (PMO) handles the other components on behalf of the Ministry of Agriculture. Out of the ADB allocation of SDR 14.743 million, SDR 11.562 million has been set apart for the credit component for refinancing of loans granted by the PFIs. The Project covers 17 districts, and is scheduled to be completed in 2004.

In 2001, the extension services provided by the PMO were privatised in some districts on the recommendations of the ADB funded Technical Assistance Programme for Privatisation of Advisory services under the Project. The PMO also started charging fees from the borrowers for the services provided by the Project's Extension Officers in the remaining districts with effect from November 2001. The objectives of this move were; (a) to establish private entities for rendering farm advisory, marketing, extension and technical services to the clients to ensure the provision of a sustainable and continuous service even after the termination of the Project; and (b) to establish competitive market based fee structure and a 'user-pays' system.

According to the recommendations of the ADB Mid Term Review Mission -2001, capital cost of constructing poly tunnels for cultivation of high-valued vegetables such as bell pepper and capsicum was included for financing under the Project. Previously, the Project could finance only the cultivation of perennial crops and flowers under poly tunnels.

During the year under review, a sum of Rs.323 million had been approved to 484 eligible sub-projects out of which Rs.274 million had been disbursed. Accordingly, the PFIs were able to achieve 92 per cent of the disbursement target during the year. The Central Bank had released Rs.212 million by way of refinance. The value of loans granted by the PFIs and the amount of refinance granted by the Bank at the end of 2001

TABLE II-11
Credit Schemes Operated by the Rural Credit Department during 2001

Name of the Project	Funding Agency	Broad Mission	Original Allocation	Annual Interest Rate to the Borrowers	Credit Disbursement upto 31.12.2001 (Rs.Mn)	Recovery Rate where applicable %
1 Tea Development Project (1999-2005)	ADB	Increase tea small holders income on a sustainable basis and to improve the natural environment in the project area.	SDR 15.4 Mn	Average Weighted Deposit Rate (AWDR) + 2 (for Replanting) AWDR + 6 (for other purposes)	1,044	91
2 Second Perennial Crops Development Project (1998-2004)	-do-	Increase the production and commercialization of Perennial Crops, development of nurseries, post-harvest handling and processing activities and marketing.	SDR 11.562 Mn	AWDR + 2	588	90
3 Skills Development Project (Year commenced 2000)	ADB	Improve Quality and relevance of skill training programmes to build a high quality workforce and address issue of skills mismatch and unemployment among rural and urban youth	SDR 0.657 Mn.	AWDR+2	-	-
4 North-Central Province Participatory Rural Development Project (1996-2002) North-Central Province Rural Development Project (1997-2003)	ADB, IFAD, SIDA and WFP	Poverty Alleviation, improves food security, nutrition and increase employment opportunities for low-income families.	US$ 0.5 Mn US$ 0.25 Mn	AWDR or 10% whichever is lower + 6 percentage points	3.3	70
5 Urban Environmental Infrastructure Development Project (1999-2001)	USAID	Improve Environmental facilities, Health & Sanitory conditions of the people living in Urban and Semi-urban areas.	US$ 4Mn	16	269	90
6 Food & Nutrition Promotion Credit Scheme (Year Commenced - 1997)	Japanese Government	Increase food production and food processing techniques in the country.	SLRs.284 Mn	10	29	96
7 Poverty Alleviation Microfinance Project (Year commenced 2000)	Japanese Bank for International Co-operation	To establish a cost effective and sustainable micro-credit delivery system to generate employment and improve savings habits.	Japanese Yen 1,368 Mn	Market Rates	1.2	under grace period
8 Matale Regional Economic Advancement Project (2000-2006)	IFAD	Permanent raising and sustaining of income of small enttrepreneurs of rural and farmer families of project area.	SDR 2 Mn.	14	33.6	80
9 New Comprehensive Rural Credit Scheme	PCIs with govt. interest subsidy	Granting of credit for (i) cultivation of paddy and other short-term food crops, (ii) pre and post-cultivation activities under Forward Sales Contract System.	-	12	638	64(a)
10 Small Farmers & Landless Credit Project (1990-2000)	IFAD, CIDA, and GOSL	To establish a cost effective and sustainable micro-credit delivery system to generate employment and improve savings habits.	SDR 4.85Mn	Agriculture - 16 Other Purposes - 20	753	97
11 Kegalle District Integrated Rural Development (Revolving Fund) Project (1997-2007)	Government of Sri Lanka	Uplift the standard of living of the people in the Project area by promoting income-generating activities.	SLRs.100 Mn	10	179.5	94
12 Surathura Programme Phase II	PCIs with govt. interest subsidy	Increasing income and improving living standards of unemployed educated youth by promoting self-employment among them.	SLRs 1,300Mn	10	596	78
13 Southern Province Rural Development (Revolving Fund) Project (from 2000)	-do-	To improve the quality of life of the people in the Southern Province.	US$8.1 Mn	12	145	88

(a) Approximately overall position

stood at Rs.588 and Rs.419 million respectively. Though there had been some slowing down of the disbursement of credit due to the privatisation of extension services in the 1st half of 2001, disbursements picked up by the end of the year.

Ruhuna Development Bank was included in the Project as a PFI during 2001, increasing the total number of PFIs to eight under the Project.

Skills Development Project (SDP)

Skills Development Project funded by the ADB came into effect in terms of the loan agreement for the Project entered into between the Government and the ADB on 15.11.1999. Under the agreement, the ADB provides a loan of SDR 13.7 million for the Project which is implemented by the Ministry of Vocational Training (MOVT), on behalf of the Government, for a period of six years from March 2000 to August 2006. On a request made by the MOVT, the Central Bank has participated in the implementation of SDP since December 2000. The Bank is responsible for providing refinance against the sub loans granted to eligible borrowers who have completed the Skills Development Programmes conducted by the Ministry. Out of the total allocation, a sum of SDR 657,000 has been allocated for the credit component for providing initial financial support to establish small scale entrepreneurial or self-employment activities. The loan size is between Rs.50,000 and Rs.250,000.

The objectives of the Project are to improve the quality and reliance of skills development programmes with a view to building a high quality workforce through restructuring and reorientation of the vocational training system by introducing competency based training and promoting a closer partnership between vocational training institutions and the private sector. Preliminary arrangements were made by the Bank to sign the Administration Agreement with the Government and the Subsidiary Loan Agreements with PFIs. The Project's lending activities are expected to commence in early 2002.

ADB funded North Central Province - Rural Development Project (NCP-RDP) and IFAD funded North Central Province – Participatory Rural Development Project (NCP-PRDP)

The IFAD funded North Central Province – Participatory Rural Development Project (NCP-PRDP) and the ADB funded North Central Province –Rural Development Project (NCP-RDP) commenced operations in 1996 and 1997, respectively. Both are Integrated Rural Development Projects implemented with the objective of poverty reduction and balanced regional development in the Anuradhapura and Polonnaruwa districts.

The Central Bank is the apex-coordinating agency for the credit component of both Projects. The credit components are aimed at poverty alleviation by improving income generating activities and creating employment opportunities in the North Central Province. The NCP-RDP was originally designed to disburse credit through commercial banks out of their own funds, without refinance support, on an experimental basis. People's Bank, Bank of Ceylon, Hatton National Bank and the Seylan Bank were the Participating Credit Institutions (PCIs). The credit component of the NCP-PRDP was originally designed to be funded by the National Development Trust Fund (NDTF). However, this programme could not be implemented due to the non-availability of funds from the NDTF. Subsequently, since 1998, arrangements were made to implement the credit component through PCIs with their own resources as in the case of the NCP-RDP.

Disbursements of credit under both Projects by the PCIs amounted only to Rs.3.3 million by mid 2000. However, it was originally expected that PCIs would grant Rs.196 milion as credit out of their own funds during the project period. Considering the poor performance, the Mid-term Review Missions of the ADB and IFAD in 2000 agreed to provide refinance support to the PCIs for granting loans for establishing income generating activities during the remaining project period. Accordingly, both credit schemes were redesigned in 2001. The ADB and IFAD allocated US dollars 500,000 (approximately Rs.40 million) and US dollars 250,000 (approximately Rs.20 million) respectively to provide refinance to PCIs.

The refinance rate of interest for PCIs was set according to the annual average of Average Weighted Deposit Rate (AWDR), subject to a maximum of 10 per cent per annum. The lending rate applicable for borrowers is to be 6 percentage points above the AWDR. The refinancing is available upto 70 per cent of the total cost of the sub-project, while the borrower and the PCIs are required to meet the balance 10 per cent and 20 per cent, respectively.

The credit component of the NCP-RDP was revised as an Enterprise Development component in order to revitalise the Project's initiatives to develop agricultural and non-farm income generating activities in 12 clusters, identified as the potential areas for enterprise development, which were assisted by the Project in providing the required infrastructure. In order to ensure effective and efficient delivery of the enterprise development services, arrangements have been made to contract out the support services to service providers selected from the private sector. An Enterprise Development Centre was established in 2001 within Project Management Office (PMO) to monitor and evaluate the performance of the service providers.

The target group of the credit component of the NCP-PRDP remained unchanged i.e. the self-help groups who have gone through the social mobilisation programmes under the Project. In 2001, the Central Bank entered into an Administration Agreement with the Ministry of Plan Implementation and Subsidiary Loan Agreements with PCIs to implement both credit programmes with effect from 01 May 2001. The new operating instructions were issued to the PCIs, and a Project Evaluation Committee was established in 2001 to evaluate the eligibility of the sub-project proposals to be financed under these projects.

During the year 2001, 29 loans have been disbursed by the PCIs under the NCP-PRDP, while the NCP-RDP had engaged in selection of service providers. Refinance has not been released during 2001 under the two projects.

Urban Environmental Infrastructure Development Project (UEIDP)

The Urban Environmental Infrastructure Development Project (UEIDP) which commenced operations in 1999, successfully completed its operations with 100 per cent utilisation of funds i.e. Rs.269.2 million by 31.10.2001. The scheme was funded with the proceeds of a loan from the government. The government borrowed a sum of US dollar 4 million from a private investor in USA viz. Lazard Freres and Co. Ltd. through the United States government in September, 1998 by issuing a Fixed Rate Promissory Note to provide funds for the Project. The objectives of the Project were to promote the private sector participation in environmental development, particularly in the urban and semi-urban areas, providing credit to Local Government Authorities (LAs), NGOs and interested individuals for the implementation of garbage disposal, water supply and sanitation, waste water treatment, drainage systems and other environmental development projects, to ensure the development of health conditions of people living in those areas and to improve the environmental conditions. The role of the Central Bank was to implement the credit programme through the PCIs namely; the six (6) Regional Development Banks, NDB and SANASA Development Bank, by granting refinance in respect of loans extended by those lending institutions. The Project was an experiment carried out by the government to test the possibility of using a market rate based private sector loan to fund the private infrastructure development activities. The credit facilities were mostly used by individuals and communities. 82 per cent of the loan funds i.e. Rs.221.8 million was granted for providing loans for obtaining tap water and sanitation facilities, and the balance was for financing the construction of drainage systems, community water supply schemes, building pavements, kitchen development and drinking water systems, improvement of fertiliser (compost) projects and the purchase of tractors and trailers by municipal councils for waste disposal.

The Project's foreign funding arrangements ceased by end October, 2001. The Bank took initiatives to continue the project activities by re-cycling the recoveries of loans granted earlier and the interest income from investments through a revolving fund.

Food and Nutrition Promotion Credit Scheme (FANP)

The Central Bank commenced the implementation of the FANP Credit Scheme in 1997 at the request of Ministry of Agriculture. The Government provided a sum of Rs.284 million out of the counterpart funds of the Japanese Food Promotion Grant, received by it for implementation of the Credit Scheme. The scheme was designed to channel credit through farmer organisations, co-operatives, and Thrift and Credit Co-operative Societies. At end 2001, the total sum financed amounted to Rs.29 million. The main reason for the under-utilisation of credit was the difficulties encountered by co-operatives and farmer organisations in providing collateral acceptable to banks for obtaining loans. The Bank has been negotiating with the Ministry of Agriculture to revise the scheme with a view to expediting the disbursement of credit.

Small Farmers and the Landless Credit Project (SFLCP)

The Small Farmers and the Landless Credit Project inaugurated in 1990 and jointly funded by the IFAD – a loan of US dollars 6.7 million, CIDA – a grant of US$6.6 million and the Government – a contribution amounting to US dollars 4.1 million by the Central Bank. The Project aims at setting up an effective credit delivery mechanism for channelling institutional credit for income generating activities of the rural poor who have no access to credit from formal institutions. The Project also expects to improve the economic and social conditions and the general welfare of the beneficiaries.

The SFLCP dubbed as "ISURU" bears a cost effective credit delivery system and has been in operation in four districts viz., Galle, Matara, Kandy and Puttalam. The Project relies on the credit plus approach which includes the linkage of banking system, strengthened by the group lending strategy to achieve its objectives. The Bank functions as the executing agency on behalf of the Government. The staff released from the Regional Development Banks in the relevant districts handle management and field level operations of the Project.

The foreign funding for the Project ended in December 1997 as originally scheduled, and in 1999, the Bank continued to implement the Project activities by recycling the loan recoveries as provided for in the Loan Agreement signed with the IFAD.

At end 2001, the Project had covered 3,246 villages in the four districts. 12,127 Self-help Groups (SHGs) of the identified beneficiaries had been formed for providing assistance. The total number of beneficiaries in these groups stood at 72,185, and this was well above the target of 32,000 set in the project design. The most striking feature of the Project was the high participation of women in project activities. The number of women amounted to 50,988, accounting for 70 per cent of the total number of beneficiaries. At the end of the year, a sum of Rs.753 million had been advanced as micro loans to enable the borrowers to undertake income generating self-employment activities. The average size of a loan amounted to Rs.11,120. The Project has consistently maintained a high cumulative recovery rate of over 97 per cent. In addition, the beneficiaries had saved Rs.109.3 million through compulsory savings and voluntary group savings as at end 2001.

In 2001, as in the previous years, loan recoveries were recycled to provide refinance to the Regional Development Banks in the relevant districts, while the interest income earned by investing excess funds was utilised to meet the administration and beneficiary training expenditures of the Project.

The Bank continued with the setting up of Isuru Development Societies (IDSs) by encouraging the SHGs to amalgamate themselves into formal corporate bodies during 2001. This was a scheme inaugurated in 1997 to facilitate the matured SHGs to strengthen their fund base, improve negotiation capacity and enhance synergical power. Accordingly, several SHGs operating in villages were formed into IDSs and were registered with the Registrar of Companies as limited liability societies under the Societies Ordinance. By end 2001, 203 such limited liability societies had been formed, recording an increase of 16 societies during the year. Federating the individual societies at the district level has been carried out in the four districts. The members of the federations were elected by the society members from among themselves.

During the year, Isuru District Federations have expanded their activities to develop the economic, social and cultural skills of the members. Scholarship funds have been established in the Kandy and Matara districts aimed at providing financial assistance to needy children of members of Isuru Societies. With a view to providing avenues to sell the products of the beneficiaries, Trade Fairs and Exhibitions were organised in the four districts. Programmes were also launched by the Isuru Project to supply herbal plants to a private sector company and to the Sri Lanka Ayurvedic Drugs Corporation by entering into forward sales contracts. In addition, the Isuru Project has organised the distribution of herbal plants and other economically viable plants among beneficiaries in Puttalam and Galle districts respectively for protecting the environment and earning additional income in the long run. A new method of paddy cultivation called "System of Rice Intensification (SRI)" has been introduced on an experimental basis by the Isuru Project in the Puttalam district for its beneficiaries engaged in the paddy cultivation. SRI minimises costs and increases yields.

The diversification of activities undertaken by the Isuru Development Societies is a reflection of the improved capacity of the societies. The issued share capital and savings of the IDSs amounted to Rs.7.9 million and Rs.9.5 million respectively as at the end of 2001. The loans granted by the societies out of their own funds stood at Rs.79 million.

Poverty Alleviation Microfinance Project (PAMP)

The Poverty Alleviation Microfinance Project funded by the Japan Bank for International Co-operation (JBIC), is a replication of the Small Farmers and Landless Credit Project (SFLCP), presently being implemented by the Bank in Galle, Matara, Puttalam and Kandy districts. The Project extends credit facilities to rural poor and landless families on a group lending concept and a credit plus approach (i.e. credit plus support services) as the main strategy for achieving its objectives. The Project is operational in six districts namely; Kalutara, Hambantota, Badulla, Nuwara Eliya, Matale and Kurunegala. PAMP has the same objectives and target beneficiaries as in SFLCP. Establishing a cost effective and sustainable micro credit delivery system, encouraging rural women to participate in income earning economic activities, inculcating savings habits and thrift among the poor, improving vocational, entrepreneurial and functional skills of the poor, building up self confidence in the rural poor and weaning them away from the dependency mentality are the main objectives of the Project. Target beneficiaries of the PAMP are households whose monthly income is less than approximately Rs.3,000/-, and do not possess a four wheel vehicle, who have not obtained facilities under other microfinance schemes and are not defaulters to any other financial source.

RDBs in the relevant districts function as the PFIs under the Project. Some Non- Governmental Organisations (NGOs) operating in the project areas were admitted as Partner Agencies (PAs) to assist the RDBs in identifying target groups and developing them into bankable customers, in granting loans and in recoveries. The foreign funding from JBIC for the project will end on 31.12.2006. According to the agreement between the Government and the JBIC, the project activities by the Bank are expected to continue for a further period of 20 years, utilising the revolving fund comprising loan recoveries and interest income.

The Department has established the institutional structure by establishing Project District Offices (PDOs) and appointing Project District Co-ordinators (PDCs) for carrying out district level activities and providing co-ordination with PAs. As at 31.12.2001, 1,687 groups were formed with 9,127 beneficiaries. The amount collected in the form of group savings amounted to Rs.1.4 million. The number of loans disbursed and the amount disbursed under the Project at end 2001 stood at 130 and Rs. 1.2 million, respectively.

Matale Regional Economic Advancement Project (MREAP)

IFAD funded Matale Regional Economic Advancement Project which came into operation in 1999 continued its functions in year 2001. One of the major features of the Project is the effective participation of the private sector. According to the original project plan, the project is expected to have a greater participation from the civil society, including NGOs, in project management, which is a deviation from the usual IRDP schemes implemented by the Government. The objective of the Project is the raising of income of rural poor and farm families in the project area on a permanent and sustainable basis. The Bank functions as the executing agency for the rural financing component of the Project. The Matale Regional Office of the Bank is responsible for co-ordinating activities at the regional level and monitoring and supervision of credit scheme is the responsibility of the Rural Credit Department.

Out of the loans provided to the Government, SDR 2.0 million has been allocated for refinancing loans granted by the PCIs under the Project. A Project Management Office under the Regional Development Division of the Ministry of Plan Implementation was established in Matale. This office assists the implementation of the rural finance component of the project.

The Kandurata Development Bank (KDB) was included as the first PCI under the Project in January 2001, and six new PCIs, namely, People's Bank, Bank of Ceylon, Hatton National Bank, Seylan Bank, Sampath Bank and SANASA Development Bank are also to be included under the Project. The department issued operating instructions to PCIs for the implementation of the rural finance component of the project. During the year KDB has disbursed Rs. 33.6 million to beneficiaries under the credit scheme.

New Comprehensive Rural Credit Scheme (NCRCS) including Forward Sales Contract System

The New Comprehensive Rural Credit Scheme (NCRCS) has been in operation throughout the country providing short-term cultivation loans for paddy and subsidiary food crops. Activities with respect to the Forward Sales Contract Scheme were also vigorously pursued during the year under review. A detailed discussion on both schemes are included in this report in Part I under the Section on Rural Banking and Credit.

Kegalle District Integrated Rural Development (Revolving Fund) Project (KGIRDP(RF))

The Kegalle District Integrated Rural Development Project (KGIRDP) was implemented in the Kegalle District with financial assistance from IFAD from 1986 to 1996. The Project was terminated, as scheduled, in 1996. The credit component of the Project was implemented through the People's Bank, the Bank of Ceylon and the then Regional Rural Development Bank (RRDB), Kegalle.

After the termination of the Project, the Bank established and maintained a revolving fund out of the recoveries from the PCIs under the credit component of the KGIRDP, in order to continue providing refinance facilities to PCIs for agriculture and self-employment loans to low income groups, entrepreneurs and youth in the Kegalle District.

The mechanism used in the KGIRDP(RF) for delivery of credit was to employ Business Development Officers (BDOs) under the Project Management Unit. They identify the eligible borrowers and prepare business development plans and finally direct them to the PCIs for obtaining credit.

Having considered the high demand for credit, the extension of the KGIRDP(RF) to the Ratnapura District with a view to covering the entire Sabaragamuwa Province has been approved. A sum of Rs.25 million has been allocated initially for providing refinance in the Ratnapura District. The credit delivery system which has been operative in the Kegalle District will be adopted in the Ratnapura District as well.

The Project has financed 4,738 sub-projects worth of Rs.179.5 million at the end of 2001. The PCIs i.e., People's Bank, Bank of Ceylon and the Sabaragamuwa Development Bank had granted Rs.55.51 million during the year 2001. The overall recovery rate of the Projects was 94 per cent at the end of 2001.

Surathura Programme-Self -Employment Promotion through Micro Enterprise Credit Scheme

The three PCIs of the Surathura Programme, Bank of Ceylon, Peoples Bank and Hatton National Bank, continued lending under the second phase of the programme out of their own funds at an interest rate of 10 per cent per annum. The Government continued to pay a 10 per cent interest subsidy to the PCIs. Under Phase II, it is targeted to grant loans to the value of Rs.1,300 million to eligible borrowers to undertake income generating self-employment projects. The scheme provided loans to the unemployed, particularly, educated youth, to enable them to commence new projects or to expand existing projects.

During the year under review, the PCIs had granted Rs.13.9 million for 500 projects, increasing the total amount granted under phase II to Rs.596.42 million as at end 2001. The Central Bank also continued to monitor the recoveries of loans granted under Surathura Phase 1 which completed its operations in 1997. Under Phase I of the scheme, the government had granted a sum of Rs.350 million to provide refinance to PCIs at an interest rate of 4 per cent per annum with a repayment period of 7 years, including a grace period of 5 years.

Southern Province Rural Development Project (Revolving Fund) Credit Scheme (SPRDPCS)

Southern Province Rural Development Project (Revolving Fund) Credit Scheme was introduced in July, 2000 to continue with the credit activities of the ADB Funded Southern Province Rural Development Project which was completed in June, 2000. The total allocation for the Revolving Fund amounted to Rs.194 million. The activities of the rural micro and small and medium scale industries were continued in the districts of Galle, Matara and Hambantota with credit funds made available through the PCIs of the Credit Scheme.

Financing of self-employment, small and medium scale industries, livestock activities and agricultural activities for enhancing the income level and creation of employment opportunities to improve the quality of lives of the people in the Southern Province was the major objective of the credit scheme.

The total disbursement of credit in 2001 amounted to Rs.145 million, while the Bank refinance during the year stood at Rs.128 million bringing the total refinance to Rs.166 million at the end of the year.

Regional Offices

The Rural Credit Department (RCD) was assigned the function of monitoring the activities of the three Regional Offices (ROs) of the Central Bank in September, 2000. Since then, the Department has been overseeing the main functional areas of the ROs, including regional cheque clearing, currency operations (only in Matara and Anuradhapura), data collection, development credit and other lending schemes and the general administration of their offices.

While the ROs continued to carry out the above functions, they placed greater emphasis on activities associated with social and economic development in their respective regions. Accordingly, ROs have given high priority to carry out action oriented awareness programmes on forward market arrangements for agricultural commodities. In this endeavour, the Regional Offices played a co-ordinating role to bring the parties together with the assistance of the banking community in the area. The two State Banks, Regional Development Banks and a private bank actively supported the ROs in the promotion of this scheme.

In addition, ROs assisted the RCD in the implementation of some of the donor funded credit schemes by way of organising borrowers, educating and liaising between lending banks and the beneficiaries under the respective projects. The responsibility of implementing three such projects in the North Central Province and in the Matale District have been assigned to the Regional Offices in Anuradhapura and Matale.

Regional Office, Matara

The Regional Office, Matara continued to carry out the functions of development banking, data collection, currency operations, research and statistics and other development related activities during the year 2001. Development banking activities included the promotion of Forward Sales Contracts with the assistance of the Ruhuna Development Bank (RDB), assisting in the implementation of the Poverty Alleviation Microfinance Project (PAMP) in the Hambantota district and the Small Farmers and the Landless Credit Project in the Galle and Matara districts, co-ordination of other donor funded credit programmes implemented by the RCD, and implementation of village adoption programmes in collaboration with the RDB in the area.

The RO conducted a series of awareness progrmmes on the Forward Sales Contract Scheme among the farmers, who grow paddy, green gram and fruit in the Southern Province. During the year under review, the RO was able to promote 343 forward sales contracts with a value of Rs.25.0 million between paddy farmers and local millers/buyers in Ambalantota and Angunakolapelessa in the Hambantota district.

Under the traditional Central Banking functions, the RO continued to carry out currency operations and also assisted the Bank by collecting coins that remained out of circulation. During the year under review, RO was able to send three consignments of 1,973 bags of coins to the value of Rs.4.283 million to the Currency Department of the Bank. Further, the RO continued to provide deposit and withdrawal facilities for commercial banks through current accounts, and exchange facilities to general public. During the year under review, six commercial banks operating in the region had deposited Rs.2,695.7 million while withdrawing Rs.4,402 million from the Currency Unit of the Regional Office, Matara.

In addition, the RO continued to assist the Statistics Department (STD) of the Bank in the island-wide data collection scheme by collecting producer, wholesale, retail prices of major food items on a weekly basis from the Matara centre and six other centres in the Matara district on a monthly basis. The RO assisted the STD by undertaking random test checking and meeting investigators in the Southern Province who under the island-wide data collection schemes. Further, at the request of the STD, RO conducted a survey on small scale enterprises in the Divisional Secretariat Divisions in the Matara and Galle districts during the year 2001.

Other development activities carried out by RO during the year under review included conducting of five beneficiary training programmes (162 participants), 14 educational seminars for higher grade students (425 participants), assisting the Sri Lanka Heritage Project of the Bank and the Business Incubator introduced by the University of Ruhuna and the activities of the Southern Development Authority (SDA).

Regional Office, Anuradhapura

The RO, Anuradhapura continued to carry out its main activities of development lending and micro-enterprise development, promotion of the Forward Sales Contract Scheme implementation of two donor funded credit programmes i.e. North Central Province – Rural Development Project (NCP-RDP) and North Central Province – Participatory Rural Development Project (NCP-PRDP). The RO also continued to engage in organising educational seminars for school children, collection of price information and data, currency operations and sale of Central Bank publications, etc.

RO was vigorously engaged in the promotion of the Forward Sales Contract Scheme in Anuradhapura and Polonnaruwa districts, and was able to promote the signing of 3,981 contracts for paddy, maize, soya and B'Onion to the value of Rs.187.4 million with the assistance of People's Bank, Bank of Ceylon Seylan Bank and Rajarata Development Bank.

RO assisted the STD by collecting data on producer, wholesale and retail prices of major consumer goods from the Anuradhapura centre on a weekly basis, and conducted a seminar for the benefit of data collectors under the islandwide data collection schemes of the STD. Further, at the request of the STD, RO assisted the Small Business Survey in Anuradhapura District.

Under the microfinance development activities, RO assisted the NCP-RDP and NCP-PRDP in identifying suitable borrowers, and educating them on enterprise development prior to referring them to banks for financing. RO conducted two seminars for PCIs in order to make them aware of the revised projects.

RO conducted/organised a number of skills development training programmes and awareness programmes for loan beneficiaries, including 10 day programme on dress making for 14 unemployed women, 9 programmes on post-harvest technology for selected farmers, and 3 day residential programmes on integrated farming at the Mahaberiyatenna Government Farm during the year, 2001.

Under the traditional Central Banking activities, RO engaged in currency operations and regional cheque clearing operations. The volume of currency issued to the commercial banks amounted to Rs.7,263.0 million and the currency deposited by the bank amounted to Rs.1,555.8 million in the year 2001. RO was able to collect coins worth of Rs.10.2 million from various religious institutions in the district for the Currency Department of the Bank. During the year under review, a total number of 242,380 cheques valued at Rs.7,273.5 million were cleared through the Anuradhapura regional clearing house.

Regional Office, Matale

The Regional Office, Matale continued to carry out its developmental functions in the Matale, Nuwara Eliya and Kandy districts during the year under review. The main activities of the RO included the promotion of Forward Sales Contracts for agricultural commodities, conducting educational/awareness programmes for farmers and entrepreneurs on post-harvesting technology, high tech agriculture, entrepreneurship development and livestock development. Accordingly, 60 farmers were trained in hytech agriculture at Bindunuwewa In-service Training Centre, 127 meetings were conducted on Forward Sales Contracts in the Matale, Kandy and Badulla districts, 9 programmes were held on post-harvest technology with the assistance of the Institute of Post Harvest Technology and the Ministry of Agriculture during the year 2001.

The RO, Matale promoted 1,875 forward sales contracts between farmers and buyers in respect of paddy, B'onions, pepper and maize during the year under review. In this endeavour, the RO was assisted by the Kandurata and Uva Development Banks, Bank of Ceylon and Sarvodaya SEEDS, acting as facilitators for the contracts.

During the year under review, the RO continued the activities relating to credit schemes implemented by the RCD i.e. Tea Development Project, Perennial Crops Development Project, Kegalle District Integrated Rural Development Project, Poverty Alleviation Microfinance Project and the Small Farmers and the Landless Credit (ISURU) Project in the Kandy District. In addition to the above, the responsibility for the implementation of the credit component under the Matale Regional Economic Advancement Project (M-REAP) was assigned to the RO, Matale on behalf of the RCD.

The RO continued to carry out the operations of two clearing houses in Kandy and Matale. The Kandy Clearing House handled 803,402 cheques to the value of Rs.24,969 million, while the Matale Clearing House handled 94,599 cheques to the value of Rs.1,913 million during the year 2001.

Research Activities

In fulfilment of its statutory obligations, the Economic Research Department (ERD) provided information, analyses and policy advice to assist the Bank's management and the Monetary Board in the conduct of monetary policy and the performance of the Bank's function as the economic advisor to the government. In order to do so, ERD collated, compiled and analysed information related to economic activity, both in Sri Lanka and outside Sri Lanka, and conducted research in relevant areas. As a major task of ERD is the provision of information on economic affairs to the public, several measures were taken to improve data dissemination and provide accurate and comprehensive information in a timely manner. The Department provided policy advice on various issues to other departments in the Bank and to the Ministry of Finance. The technical skills of the staff of ERD were extensively used both by other departments of the Bank and by outside agencies and institutions, as officers from ERD were frequently called upon to serve as resource persons and experts at various fora.

ERD took further steps during the year under reference to improve its monetary policy advisory services. A technical assistance (TA) mission from the IMF on monetary and foreign exchange operations was in Sri Lanka in 2001 to assist the Bank to formulate a framework for monetary and foreign exchange operations following the move to an independently floating exchange rate regime. Based on the recommendations, ERD is working with other departments in the CBSL, and financial institutions, to strengthen the move towards a more market oriented monetary management in the country. In the context of the Central Bank's move towards achieving its primary objective of price stability, emphasis was placed on improving the monetary policy framework. A Monetary Policy Committee (MPC), consisting of six members, was set up within the Bank. While several officers from ERD serve on this Committee, ERD is also primarily responsible for preparing papers for the deliberations of the MPC.

As the Central Bank intends to move towards an inflation targeting framework in the medium-term, an 'Inflation Targeting Group' was established to report on the requirements of moving to such a framework. The members of the committee were drawn mainly from ERD.

ERD co-ordinated Sri Lanka's relations with the International Monetary Fund, the Inter-governmental Group of Twenty Four (G-24), the SEACEN Centre and the SAARCFINANCE grouping of Central Bank Governors and Finance Secretaries of SAARC countries, while also assisting the Ministry of Finance in planning and co-ordinating activities with the World Bank (WB), the Asian Development Bank (ADB) and other multilateral and bilateral donors. In this context, ERD was primarily responsible for co-ordinating work relating to three major programmes with international financial institutions, viz, the Stand-By Arrangement (SBA) of 2001 with the IMF, the Report on the Observance of Standards and Codes (ROSC) and the Financial Stability Assessment Programme (FSAP).

The SBA is a programme (see Box article in Part I for details) under which the IMF provides a credit facility to a country. It serves as an endorsement of confidence of the international community in the economic policies of the country and helps attract assistance from other international financial institutions and bilateral donors as well.

The ROSC programme was established following the international financial crisis in the late 1990s, as the international financial community has sought to develop international standards and codes to provide benchmarks of good practice in key policy areas. As a part of this process, the IMF has been producing ROSC since 1999 with the objective of promoting increased transparency and encouraging the implementation of internationally accepted standards and codes. As a ROSC mission provides an opportunity for an in-depth study of a country's statistical system and demonstrates the authorities' commitment to transparency and adherence to international standards, Sri Lanka's decision to participate in this programme is beneficial.

Sri Lanka also participated in an FSAP mission, which is a collaborative work of the IMF and the World Bank. The principal aim of FSAP is to promote economic development with stability. The work of the mission is to provide a valuable set of tools in identifying the strengths, weaknesses, risks and vulnerabilities in a country's financial system and the need for institutional development in the financial sector. Both developed and developing countries participate in FSAP. Sri Lanka is in the second group of counties to participate in the programme.

ERD also continued to host the SAARCFINANCE Cell of Sri Lanka in 2001. SAARCFINANCE is a grouping under the SAARC umbrella that brings together the Central Banks Governors and Finance Secretaries of SAARC countries. As Sri Lanka held the chairmanship of SAARC throughout 2001, ERD served as the Secretariat for the SAARCFINANCE group. This required the co-ordination of inter country activities and the organisation of the SAARCFINANCE meeting, which is held before the Annual IMF/World Bank meeting.

A vital part of the functions of the Department relates to the dissemination of information on economic matters to the public. ERD provides such information with periodicities varying from daily to annual, through Central Bank publications, its website and to the media. An on-going process of improving the coverage and timeliness of such information is implemented by ERD. In view of the increasing demand for electronically accessible information, much attention was given to improving the availability and presentation of information contained in the Bank's website, which is maintained by ERD. The website is accessed on a daily basis, particularly by international organisations and researchers. A novel event introduced in 2001 to improve the dissemination of information was a seminar early in the year for Primary Dealers and Foreign Exchange Dealers at which the Bank provided information on its economic projections for the year. The Department continued to compile and publish key aggregate interest rates such as Sri Lanka Inter Bank Offered Rates (SLIBOR), the average weighted prime lending rate (AWPLR) of commercial banks, and the average weighted deposit rate (AWDR) of commercial banks. These indices are acquiring increased importance as benchmark rates for market based financial instruments.

The Department was responsible for contributing to and co-ordinating the publication of the Bank's Annual Report for 2000, in co-operation with other Departments. The Department also published a special publication "Recent Economic Developments – Highlights" for presentation with the Budget 2001. In addition, the Monthly Bulletin, containing a wealth of economic data, was published. The Department, in fulfilment of the statutory obligation under section 116 of the Monetary Law Act, prepared and submitted to the Minister of Finance, a special report known as the September 15th Report to facilitate the preparation of the Budget for 2002.

ERD was responsible for the compilation and publication of fundamental data on monetary aggregates and balance of payments. The publication of the monthly private sector industrial production index continued, while the detailed half-yearly and annual private sector industrial production surveys also continued. In view of the increasing importance of the IT industry, discussions were held with industry participants on setting up an ongoing survey of IT activity. The Department was also responsible for co-ordinating the work of the committee set up by the Treasury on the instructions of the President to assess enterprises closed down in recent years.

Officers from ERD undertook a number of research studies, both to fulfil the Bank's needs and on their own initiative. Some of these were joint studies with researchers in other institutions. Several studies have been selected for publication in the "Staff Studies" of the Bank.

Many senior officers of ERD served on important committees, both within the Bank and outside. Among these were the Committee on WTO Safeguard Measures, Committee on Removal of EU Quota Restriction on Textiles and Garments, Committee on Sri Lanka Pakistan Trade Agreement, Task Force on Establishment of a SAARC Regional Training Centre, Task

Force on Postgraduate Training Requirements, the Monetary Policy Committee, the Balance of Payments Committee, the Exchange Rate Committee, the Treasury Bills and Treasury Bonds Tender Committees, the Liquidity Assessment Committee, the Open Market Operations Committee and the Domestic Debt Management Committee. Officers of the Department represented the Central Bank in the Core Group on Taxation of the Ministry of Finance and Planning, which reviews the current tax system and makes proposals for a medium term tax strategy of the government. ERD officers also served on the Boards of Directors of several institutions such as the National Development Bank, Board of Investment and the Sri Lanka Export Credit Insurance Corporation.

In order to improve staff skills, ERD continued to train its staff under the High Level Training Programme, conducted its weekly seminar series, participated actively in the Bank's monthly public seminar series, and sent its officials for training in areas of importance, to both local and overseas training programmes.

Statistics and Field Surveys

The Statistics Department continued to engage in the collection, compilation, analysis and dissemination of (a) data on national accounts, prices, wages, labour force, employment and other socio economic indicators and (b) micro level data on households and the corporate sector through its surveys.

As part of the continuous process of enhancing the quality and timeliness of data pertaining to statistically deficient areas, towards improving estimation of national income and product statistics, the Department took the initiative in 2001 to establish a data base for the small industry sub sector of the Manufacturing sector. The primary objective of this initiative was to develop bench mark estimates, which would enable direct quarterly and annual estimation of value added in this growing sector of the economy, to improve on the indirect estimation procedures that had been used in the past.

In addition, a new Quarterly Public Sector Employment Survey was initiated and conducted by the Department, that would provide timely and comprehensive data to enhance compilation of quarterly national accounts estimates in the Public Administration and Defence sector.

The price movements in retail and wholesale markets across the country were regularly and closely monitored under the continuous price collection systems of the Department. Regular analytical reports on price developments were prepared and submitted to the management to facilitate policy decisions. Meanwhile, price disseminating initiatives relating to retail and wholesale markets through print and electronic media were further strengthened to enhance awareness among market participants towards reducing price fluctuations in commodity markets in the longer term.

Efforts were also made to enhance the awareness of national economic issues of school teacher investigators in the Country Wide Data Collection System by regularly providing them with up-to-date economic data. The potential for expanding price collection coverage of newly developed market centres was also explored through field visits.

The Department also improved timeliness by the publication of its two regular publications, namely the Sri Lanka Socio Economic Data 2001 and Economic and Social Statistics of Sri Lanka 2001 within the calendar year. Meanwhile, priority was given to expanding dissemination of the information contained in these publications in electronic format as well. The former was made available to the public in both print and electronic form. It is expected that the latter publication will also be available in electronic form in 2002.

Officers of the Statistics Department were able to enhance their professional capabilities by participating in national level training programmes in relevant subject areas focussing on sample surveys and development of human development indicators. In addition, officers participated and contributed actively in seminars and workshops on relevant subject areas of national importance such as the labour market, poverty reduction and food security. A National Committee on Developing a Country Wide Consumer Price Index, chaired by the Secretary to the Treasury, was established in April 2001 which gave priority to this long-felt need. The Committee comprised the Director General of the Department of Census and Statistics, Senior Officials of the Ministry of Finance and the Director of Statistics of the Central Bank.

Surveys

Small Business Survey - 2001

In the area of sample surveys, the Department undertook a survey of Small Businesses in the latter half of 2001. The primary objective of conducting this Small Business Survey was to establish a data system on the small business sector, which would enable direct quarterly and annual estimation of the value added of small businesses in the economy. Currently, the value added estimates of the small business sector in the national income and product accounts are made on the basis of an indirect estimation procedure, as the economic activities in the small business sector are not covered by any standard reporting system. Hence, the importance of developing a systematic methodology to directly estimate value added in this sector became a priority.

The survey sample was stratified according to the 5 - zonal classification by economic activity adopted in the Consumer Finances and Socio Economic Surveys of the Central Bank. The field work of the entire survey was conducted during the period 23.7.2001 to 31.8.2001. The field investigation for the survey was outsourced to unemployed graduates from the respective localities, while field supervision was carried out by Central Bank officers. The survey enumerated a sample of 3,538 small business enterprises in the districts of Colombo, Gampaha, Kalutara, Galle, Matara, Anuradhapura and Kandy. The key information collected included the turnover, cost of inputs and employment numbers, covering two reference periods viz 2000 and the first half of 2001. The statistical tabulations required for writing the survey report were completed during the month of November. The final report of the survey is expected to be completed in February 2002.

Country Wide Data Collection System (CWDCS)

The Country Wide Data Collection System of the Statistics Department, which commenced in 1978, completed 23 years of operation in 2001. Regular collection of information on retail prices of consumer goods, producer prices of agricultural commodities, and wage rates pertaining to the informal sector is carried out under this programme. The system is also used to identify the impact of changes in the administered prices of consumer items as well as to monitor inputs for agriculture in major producing areas. The sub sectors covered by the scheme include paddy, tea, rubber and coconut cultivation, and also small-scale construction. Data collection is accomplished through an islandwide network of school teachers who function as statistical investigators in around 100 centres. Information thus collected is published regularly through the print and electronic media. Seminars were conducted in Matara, Colombo, Anuradhapura and Kandy in 2001, to provide further training for the data collectors in order to improve the quality, efficiency and timeliness of their data collection, as well as to obtain their input on the reasons for differences in price developments across regions identified in the computation of regional consumer price indices.

The daily collection of wholesale and retail prices of major food items from the Pettah market and other centres such as the Maradagahamula rice market and the Dambulla Economic Centre is also undertaken by the Department. This information is disseminated daily in the newspapers and through the electronic media to farmers, traders and consumers. The information is also used by government agencies and private sector institutions for research and business decision making such as in forward sales contracts.

A field visit to an agro economic centre in the North Western Province was undertaken to ascertain whether it was necessary to establish another price collection centre there. However, it was considered to be in a nascent stage of becoming a regional marketing centre, and the decision to establish a price collection centre there was postponed for the time being.

Computation of Price Indices

Consumer Price Indices

The Colombo District Consumer Price Index (CDCPI), introduced in 1998, continued to be computed by the Department as a supplementary index to the Colombo Consumers' Price Index (CCPI) computed by the Department of Census and Statistics. The target population used in this index is the lowest 40 per cent of the district population ranked by income. The CDCPI has a broader coverage in terms of the number of items, as well as geographically, than the CCPI. The information for the computation of the index is obtained from 11 centres in the Colombo District. Of these 11 centres, 5 centres, namely, the Pettah Market, Hanwella, Homagama, Moratuwa and Avissawella, are established under the CWDCS and the other centres namely, Kolonnawa, Nugegoda, Dehiwala, Piliyandala, Maharagama and Padukka, were newly introduced in January 1999. Officers of the Statistics Department and appointed teacher investigators collected information regularly from these centres.

Since 1998, the Department has computed three regional consumer price indices for the districts of Anuradhapura, Matara and Matale on an experimental basis. The commodity weights for the indices are based on the expenditure patterns of the respective districts derived from the Consumer Finances and Socio-Economic Survey of 1996/97 conducted by the Central Bank. The corresponding weights for the calculation of the indices were constructed based on the target population of the lowest 40 per cent of households in the district when ranked by income. These indices are useful in analysing regional price movements. They are also used by market players in negotiating forward sales contracts in agricultural commodities.

The Statistics Department continued to compile a consumer price index covering the Western Province for internal purposes. This has a wider coverage than the CDCPI, both geographically and in terms of income. The main improvement in this index is the expanded coverage of a consumer price index to higher income households and a wider geographical area. This index represents the lowest 65 per cent of households in the Western province, when ranked by income taken from the Consumer Finances and Socio Economic Survey of 1996/97. The weights are based on the expenditure pattern of the representative households. Data collection centres have been extended beyond major trading centres used for the CDCPI, to include super markets in the city to capture changing consumption patterns of the higher income households as well.

In addition to the above consumer price indices, the Statistics Department experimented with an index which represented the lowest 80 per cent of households ranked by income for the entire country, excluding the Northern and Eastern Provinces. Price information collected under the CWDCS was used for the computation of the experimental index. This exercise supported the work of the National Committee established in early 2001 to develop a country wide Consumer Price Index for Sri Lanka. It is expected that this new index, which will be compiled by the Department of Census and Statistics, will be published in 2002.

Wholesale Price Index

The Department continues to compute the Wholesale Price Index (WPI) which reflects the price movements at the primary market level. This is an useful indicator of the future price movements in retail markets.

National Accounts

The Department continued its activities in connection with the estimation of National Accounts. These included the collection of primary and secondary data and compilation of related statistics.

In 2001, the Department endeavored to strength estimation procedures of National Accounts, in general, giving wider coverage to informal and emerging economic activities. The Department conducted a survey on small businesses to enrich the database on the small industry sub sector of the Manufacturing sector, and personal services sub sector of the Services (n.e.s.) sector. The survey will be continued, on a quarterly basis, and will fill the vacuum of a regular database for the small industries sub sector. In the estimation of National Accounts, some methodological improvements were made for the Banking and other financial services, Public Administration and Defence and Other Service (n.e.s) sectors. Most of these were introduced in accordance with the System of National Accounts (SNA) 1993.

Meanwhile, the Department continued to issue quarterly press releases on current trends in the National Accounts to enhance public awareness on the subject. Also, this information continued to be dispersed through the Central Bank web-site. Timely dissemination of quarterly National Accounts data also increased public interest in the subject.

Provincial National Accounts

The Department continued to engage in the compilation of the annual Provincial Gross Domestic Production (GDP) on an experimental basis for the period from 1996 to 1999. The Provincial GDP is compiled on the basis of current factor cost prices and will soon be updated to reduce the time lag for computation of the current year as well. This will provide a comprehensive database on provincial economic activities as well as the provincial contribution to national economic development that would be useful for policy purposes.

Employment Statistics

The Department continued the annual Survey of Public Sector Employment in 2001 as well, with the objective of ascertaining the trends in employment in government ministries, departments, provincial councils, local authorities, corporations and state boards. In addition, a Quarterly Public Sector Employment Survey was initiated and conducted since the first quarter of 2001, for a sample of selected government and semi-government institutions which covered 76 per cent of the total public sector employment. This was especially planned to ascertain quarterly trends in public sector employment required for the estimation of the value addition in the Public Administration and Defence sector of the National Product Accounts.

STANET and Web Page

The Department continued to provide access to key data and press releases, as well as general information about the work of the Department through its web page "STANET" on the Local Area Network of the Central Bank. The integrated net work system provides access to and sharing of data bases between divisions and other departments of the Bank, as well as the web page of Central Bank.

Publications

Report on Subsidiary Food Crops and Animal Husbandry Survey in the Anuradhapura District - Yala 2000

This Report presenting the findings of a survey on Subsidiary Food Crops and Animal Husbandry conducted in the Anuradhapura District during the Yala season of 2000 which was completed in June 2001 and presented to the Monetary Board. The survey was undertaken on a decision made at a national level meeting on economic issues convened by the Ministry of Finance and Planning and held in late 2000. The main objectives of conducting this survey were to, (i) identify methods to improve the quality of data on the "other agriculture" sector with a view to strengthening the existing data base on national income and (ii) to review the reliability of currently available statistics on subsidiary food crops and animal husbandry. The analysis of the survey data, as stated in the report, confirmed the high variability of agricultural production in this sector and, in this context, concluded that the currently available official estimates are reliable. The report also made recommendations to improve the present methods of data collection towards obtaining more precise estimates of agricultural production in this sector.

Other Publications

During the period under review, the department continued its activities in connection with two annual publications. The department released 'Sri Lanka Socio-Economic Data 2001 - Volume XXIV' in June 2001. The second publication titled ' Economic and Social Statistics of Sri Lanka 2001 – Volume XXIII' was also completed by the end of 2001, thereby improving the timeliness of the publication further.

These two publications carry comprehensive time series and cross-sectional data on socio-economic variables, including demography, labour force and employment, national income and expenditure, agriculture, industry, external trade and finance, prices and wages, money and banking, capital market, government finance and socio-economic services.

The Department also took the initiative to prepare and release a CD-Rom containing information from the Consumer Finances and Socio Economic Survey (CFS) conducted in 1996/97. This CD-Rom incorporates the information contained in both Part I (report) and Part II (514 detailed statistical tables) publications on the above Survey.

In addition, as in the past, the Department contributed to other publications of the Central Bank as well.

Employees' Provident Fund

The Monetary Board continued to perform its functions as the custodian of the Employees' Provident Fund (EPF) during 2001 with the co-operation of the EPF Division of the Department of Labour. In terms of the EPF Act, the functions of the Monetary Board in relation to the Fund, consist of receiving contributions, surcharges, and income from investments, maintaining proper accounts of registered employments, members and the Fund, investing excess monies in suitable investments and paying benefits to the members of the Fund.

In November 2001, Wednesday was declared as the "Public Relations Day" for the convenience of EPF members.

System Improvements

The on-going process of modernising the whole EPF functions was carried out during 2001, with the collaboration of the Information Technology Department of the Bank. The main computer system of the EPF was upgraded to a more powerful AS/400 model machine with enhanced capacity. A comprehensive computer network was set up, commissioning a PC network in addition to the AS/400 terminal network. The bank reconciliation system that was previously performed manually was computerised by electronically obtaining the daily statements from banks. The initial work to set up a web site for EPF has been completed, and is to be launched at the beginning of 2002. The improvements to the system enabled EPF to continue with issuing half-yearly statements to members, prompt updating of accounts, providing more detailed statements of payments by employers to the Commissioner of Labour for enforcement purposes, conducting better treasury management and prompt repayment of benefits to members.

Investment Activities

Investment activities by EPF were carried out with emphasis on the policy of diversifying the investment portfolio with more market-based securities, and emphasis on risk-return trade off, the availability of investment opportunities while gauging the market movements. As at 31 December 2001, total investment portfolio recorded a cost value of Rs.246 bn. out of which the total Rupee Loan investments amounted to 72 per cent, against 73 per cent as at the end of 2000. In compensating that marginal drop, investments in Treasury bonds – a market oriented government investment instrument, expanded further to record 25 per cent of the total investment portfolio in 2001 from 22 per cent in 2000.

Total investments in the listed equity market amounted to Rs.1,264 mn. at end 2001, recording only a point to point increase of 9 per cent over the previous year. Total equity investments remained at 0.5 per cent of total EPF investment portfolio at the end of 2001. Equity market experienced a sluggish situation in the year under review up to October 2001, due to the economic slowdown, high interest rates and ethnic & political conditions. However, EPF continued closely monitoring the market, and carried out its investment activities on a limited scale when compared with the level of investment activities in the previous year. Listed equity portfolio generated a total return of Rs.115 mn. in the form of capital gains, dividend income and bonus shares during 2001.

It was further ensured that EPF's listed equity portfolio consisted of quality investments that were carefully selected after carrying out in-depth analyses, while gauging the market movements. Marked to market equity portfolio of EPF showed unrealised capital gains as at end December 2001.

Action was also initiated to introduce an Investment Policy Statement by EPF.

TABLE II – 12

EPF : Performace of Listed Equity Portfolio during 2000 and 2001

Rs. Mn.

Item	2000	2001
Average Portfolio	1,007	1,182
Total Dividend Income *	61	92
Total Capital Gains	25	22
Bonus Shares Received (valued at the end of the period)	251	1
Total Dividends, Capital Gains & Bonus Shares	337	115

* Inclusive of tax-saving on tax-exempted dividends

Source : Employees' Provident Fund

Secondary Market Trading Activities

EPF continued its participation in the secondary market in Treasury bonds and Treasury bills during the year 2001. The secondary market activities enabled EPF to enhance the realisable rate of return on Treasury bonds and Treasury bills. During the period under review, EPF realized a total sum of Rs.289 mn. as capital gains from secondary market activities, whereas the total capital gain recorded in the previous year was only Rs.130 mn. Table II - 13 gives the details of the secondary market operations of the EPF during the year under review.

TABLE II–13

EPF : Secondary Market Activities during the year 2001

Rs. Mn.

Item	Volume Purchased**	Volume Sold**	Capital Gain
Treasury Bonds	5,121	3,211	263
Treasury Bills	68	524	4
Equity Shares	204	99	22
Total	5,393	3,834	289

** at cost values

Source : Employees' Provident Fund

Housing Loans on EPF Members' Balances

An EPF member is eligible to obtain a loan for housing purposes from an approved lending institution, pledging the member's balance up to a maximum of 75 per cent of such balance. This facility has now been extended to obtain a second loan by the members on settlement of the first loan. In 2001, EPF issued 16,066 member balance certifications for a total approved loan amount of Rs.2,091 million. Default in paying loan instalments to lending institutions results in large penal rates being charged by lending institutions on the amount defaulted. Hence, it is in the interest of members to pay loan instalments in time.

TABLE II – 14

EPF : The Salient Features

Item	2000	2001
Number of Members		
Active Members	1,913,288	1,932,000(a)
Non-active Members	6,663,900	6,910,400(a)
Total Contributions (Rs.mn.)	16,853	17,738
Total Refunds (Rs.mn.)	10,802	11,194
Number of Refunds	95,157	93,008
Total Investment Portfolio (Rs.bn.)	215	247
Realised Rate of Return on Average Portfolio (%)	12.95	13.10
Total Members Balace (Rs.bn.)	223	256
Gross Income (Rs.mn.)	26,313	30,401
Income Tax (Rs. mn.)	2,616	2,991
Administration Expenses (Rs.mn.)	259	260
Administration Expenses as a % of Gross Income (%)	0.9	0.8
No. of Member Balance Certifications Issued for Housing Loans	12,938	16,066
Annual Interest Rate Declared on Member Balances (%)	11.50	11.50
Effective Interest Rate Declared on Member Balances (%)	11.69	11.69

(a) Estimated Source : Employees' Provident Fund

Exchange Control

In the year 2001, the Exchange Control Department (ECD) took several steps aimed at further liberalisation of capital transactions. The Department also further strengthened its monitoring activities, with a view to detecting transactions related to terrorism, in addition to detection and prevention of exchange malpractices and abuses. Activities relating to the investigation into contravention of the Exchange Control Act, registration of freight forwarders, and issuing and renewing of permits of travel agents and money changers also continued during the year.

The two major developments during the year towards the further liberalisation of the capital account were the introductions of a special account scheme known as Rupee Accounts for Non Resident Investment (RANSI) to attract foreign remittances from non resident Sri Lankans for investment in Sri Lanka, and granting permission, for the first time, for the issue of dollar denominated government bonds titled Sri Lanka Development Bonds (SLDBs) in which non residents and designated agents (authorised dealers in foreign exchange and primary dealers in government securities) were permitted to invest. Developments in the area of trade transactions were, permitting import of gold on consignment account basis by commercial banks, subject to terms and conditions laid down by the Controller of Exchange, and the removal of restrictions for import of cloves for re-export under Entrepot trade. Other developments during the year included the grant of permission to non residents to hold interest bearing accounts, and permitting authorised dealers to remit payments in respect of reinsurance premia due to overseas insurers on applications made by registered insurers, subject to the production of specified documents.

Capital Transactions

(a) Non Resident Investment in Sri Lanka

(I) The RANSI Scheme

In a bid to provide special facilities to Sri Lankan citizens living abroad and to encourage them to repatriate their earnings for investment in Sri Lanka, the Budget 2001 announced that a special scheme of investment, which would be free of exchange control, would be introduced in respect of this category of persons. Hitherto, Sri Lankans who had proceeded abroad for employment or to set up a business or in a profession and Sri Lankan citizens who had made their permanent place of abode outside Sri Lanka, who are considered as non residents for Exchange Control purposes, were not permitted to make certain investments, such as those in government securities and debentures. Under this special scheme, a special bank account titled Rupee Accounts for Non Resident Investment (RANSI), which could be held on an interest bearing basis, was introduced. Funds remitted to RANSI accounts by Non Resident Sri Lankans, such funds could be used to make investment in any financial and real assets (except bearer Certificates of Deposit), without being subject to any Exchange Control restriction. Payment for such investments had to be made by a bank draft purchased out of the funds in a RANSI account. All income from investments made through RANSI accounts, such as interest, dividends, profits and rental income, could be credited back to the RANSI account. Funds lying to the credit of a RANSI account were freely remittable abroad.

(II) Sri Lanka Development Bonds

For the first time in Sri Lanka, Dollar Denominated Government Bonds titled Sri Lanka Development Bonds (SLDBs) were permitted to be issued by the Government of Sri Lanka. Exchange Control permission was granted to designated agents (i.e. Authorised Dealers and Primary Dealers) to market such bonds to the categories of non resident persons and entities given below, who were also granted Exchange Control permission to invest in such bonds through a Special Gazette notification issued by the Controller of Exchange.

(i) Citizens of foreign states, whether resident in Sri Lanka or outside Sri Lanka.

(ii) Citizens of Sri Lanka who have made their permanent abode outside Sri Lanka.

(iii) Citizens of Sri Lanka who have proceeded out of Sri Lanka to take up employment or to set up in business or in a profession and are residing abroad.

(iv) Bodies corporate or unincorporate established under the laws of a country other than Sri Lanka.

Designated agents were also permitted to invest on their own account in SLDBs. For the purpose of facilitating the investment and marketing of these bonds, permission was granted to designated agents to maintain the following two accounts.

(i) A US dollar interest bearing account titled "Sri Lanka Development Bond Investment Account (SLDBIA)" maintained on behalf of the Government with an authorised dealer to credit funds payable to the Government and received from eligible investors who directly purchase SLDBs from the Government.

(ii) A US dollar account titled "Dollar Account for Bond Investment (DABI)" which could be maintained by a designated agent with an authorised dealer on an interest bearing basis, for the purpose of purchasing SLDBs from the Government and dealing in SLDBs with eligible investors (in the case of such designated agent who is an Authorised Dealer in foreign exchange, the maintenance of this account was not mandatory).

(b) Investment Abroad by Sri Lankan Residents

During 2001, ECD approved investments abroad by three companies. These investments were in the areas of export promotion, biscuit manufacturing and garments. The total value of investments so approved was approximately US dollars 1.18 Mn.

(c) Rupee Lending to Non-resident Controlled Companies

In 1999 all banks licensed under the Banking Act were permitted to extend rupee accommodation, including loans and advances, to non resident controlled companies, except companies approved under Section 17 of the BOI Act who have recourse to off shore units and lending institutions abroad. With effect from April 2000, this permission was extended to cover non resident controlled companies approved under Section 17 of the BOI Act as well, subject to prudential limits imposed on each bank as a percentage of its' total lending to the private sector. The initial limits imposed on the banks at the time were the following:

Foreign Banks	- No limit
State Banks	- 2 per cent of total lending to the private sector
Domestic Private Banks	- 3 per cent of total lending to the private sector
Development Finance Credit Corporation (DFCC) and National Development Bank (NDB) as Licensed Specialised Banks	- 5 per cent of total lending to the private sector

In April 2001, the prudential limit applicable to the Development Finance Credit Corporation Bank (DFCC) and National Development Bank (NDB) were enhanced from 5 per cent of their total lending to the private sector to 10 per cent.

(d) Foreign Currency Borrowings by Residents

Regulations pertaining to foreign currency borrowings by residents remained unchanged during the year. Authorised dealers are permitted to extend foreign currency loans to direct and specified indirect exporters. The Licensed Specialised banks, the NDB and DFCC are also permitted to extend foreign currency loans to exporters, provided that those banks have resources from foreign currency credit lines to do so. In the case of default of foreign currency loans secured by the mortgage of domestic assets, authorised dealers were granted the facility of applying to the Controller of Exchange for permission to convert the sale proceeds of such assets to foreign exchange. However, such applications are considered favourably only if the Controller of Exchange is satisfied that every endeavor had been first taken to recover the loan in foreign currency, and failing that, to sell the mortgaged assets for a consideration in foreign exchange.

(e) Borrowing from Abroad by Resident Companies

Borrowing abroad by resident companies, other than companies approved under Section 17 of the BOI Act with full exemption from the provisions of the Exchange Control Act, need the prior approval of the ECD. During the year, ECD did not approve any foreign loans.

(f) Blocked Funds held by Sri Lankan Emigrants and Foreign Nationals

Funds realised on the sale of capital assets belonging to Sri Lankan emigrants continued to be kept in blocked accounts, while the interest earned on funds in such accounts were permitted to be remitted after meeting tax liabilities, if any. As in the past, release of funds in such blocked accounts were permitted through commercial banks subject to an all-time limit of Rs.750,000 per individual and Rs. 1.0 mn. per family unit. Accordingly, a sum of Rs. 215.75 mn. had been remitted abroad in respect of 446 applications received from migrants during the year. Further, funds to the extent of Rs. 13.75 mn. realised by the sale of immovable property belonging to Sri Lankan emigrants were remitted out during the year.

(g) Non Resident Rupee Accounts

In the past, certain categories of non residents were not permitted to operate rupee accounts on an interest bearing basis. In order to grant the benefit of earning interest on their funds held in Sri Lanka, the following categories of non residents were permitted to operate interest bearing accounts with effect from April 2001.

(a) non nationals resident outside Sri Lanka
(b) companies registered outside Sri Lanka
(c) Sri Lanka nationals resident outside Sri Lanka
(d) Diplomatic missions and other foreign missions (eg. specialized agencies of the United Nations and other agencies) in Sri Lanka
(e) Non Sri Lankan staff of diplomatic and other foreign missions in Sri Lanka

2. Trade Transactions

During the year, towards liberalising the import of gold, regulations were made by the Hon. Minister of Finance and Planning, under the Import and Export Control Act, to permit the import of gold on consignment account basis by commercial banks, subject to terms and conditions stipulated by the Controller of Exchange. Accordingly, the Controller of Exchange notified the grant of general permission for such gold imports by commercial banks by a notice published in the Government Gazette Extraordinary No. 1186/18 of 30.05.2001. The commercial banks have also been informed of the terms and conditions applicable to import of gold on consignment account basis. In the area of Entrepot Trade, the restrictions imposed on import of cloves for re-export under Entrepot Trade was removed, subject to other normal terms and conditions stipulated for entrepot trade.

3. Registration of Freight Forwarders and Issue of Permits to Engage in Foreign Exchange Transactions

ECD continued to register freight forwarders, grant travel agencies authority to issue travellers cheques (TCs), and issue/renew licenses to money changers, and other establishments such as hotels, duty free shops, travel agents and service providers to accept payment in foreign currency on sales and services performed by them to tourists.

a. Registration of Freight Forwarders

During the year 2001, 16 new companies were registered as freight forwarders, bringing the total number of companies registered as freight forwarders to 109 at the end of the year. The ECD continued to monitor the activities of registered freight forwarders.

b. Authority for Travel Agents to issue Travellers' Cheques.

During the year no new permits were issued to travel agents permitting the issue of travellers' cheques (TCs) to residents of Sri Lanka who travel abroad. Hence the number of travel agents permitted to issue TCs remained at 7.

c. Appointment of Money Changers

During the year, the ECD issued new permits to two companies to engage in the money changing business, bringing the total number of authorised money changers to 32. Foreign currency deposited by money changers in commercial banks increased substantially from Rs.38.8 mn. in 2000 to Rs. 100.9 mn in 2001, an increase of 160 per cent.

4. Monitoring

With the liberalisation of current account transactions in 1994, Authorised Dealers (ADD) and approved travel agents were permitted to release foreign exchange without any restrictions for current account transactions exercising their judgement and discretion and after satisfying themselves with the bona-fides of the requests.

All ADDs and approved travel agents are, however, required to report to ECD sales and purchases of foreign exchange on a regular basis to enable ECD to monitor such transactions. From 1999, ADDs were also required to report releases of foreign exchange through Electronic Fund Transfer Cards (EFTCs). At present ADDs provide detailed monthly reports on EFTCs where the monthly drawings in foreign exchange exceeds US dollars 5,000 per card.

During the year, monitoring activities on the sales and purchases of foreign exchange were intensified. In particular after, Regulation No 1 of 2001 under the United Nations Act was gazetted by the Ministry of Foreign Affairs on 16/10/2001, the ECD issued several operating instructions to commercial banks, specialised banks, money changers, travel agents authorised to issue TCs and other persons and entities authorised to accept foreign currency, requiring compliance with the above regulations. Further, in order to ensure compliance with the regulations, it was also necessary to put in place a scheme to detect any foreign exchange transactions which could be connected to terrorist activities. For this purpose, a special unit was established within the ECD. Capital transfers made through Share Investment External Rupee Accounts (SIERA) were also monitored during the year.

ECD continued to monitor payments made in advance for imports in order to ensure the receipts of goods and services in the country against such advance payments. Credits and debits made to rupee accounts maintained by shipping and airline agents as well as freight forwarders on behalf of foreign principals/agents continued to be monitored during the year.

5. Investigation

The ECD continued with investigations on alleged violations of the Exchange Control Act. Investigations in respect several cases were concluded during the year, and penalties were imposed in respect of 9 cases, to a total value of Rs.1.7 million.

Public Debt

In terms of Section 113 of the Monetary Law Act, the Central Bank as the fiscal agent of the government, is responsible for the management of public debt. On this basis, the Public Debt Department (PDD) of the Bank is engaged 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 of a variety of domestic government securities, namely, Rupee loans, Treasury bills and Treasury bonds. PDD also continued to service Tax Reserve Certificates and Treasury Certificates of Deposits which were issued in the past, though their significance as a government debt instrument has now waned almost completely.

A new development in 2001 was the issuance of a foreign debt by PDD on behalf of the Government. PDD issued US Dollar denominated Sri Lanka Development Bonds (SLDBs) under the provisions of the Foreign Loans Act No. 29 of 1957.

PDD also carried out the supervision of Primary Dealers (PDs) in government securities, and implemented several measures for developing the government securities market.

Development Activities

Apart from the pioneering step of issuing US Dollar SLDBs, PDD also initiated and implemented a number of reforms to develop an efficient domestic government securities market. These included the proposed expansion of the PD system by permitting Licensed Commercial Banks (LCBs) to become PDs, the strengthening of the monitoring system and supervision framework relating to PDs, and improved dissemination of secondary market information to the public.

PDs continued to be the key players in the government securities market. With the objective of infusing greater competition, liquidity and depth into the market and improving the financial soundness of the PD system, it was decided to expand the PD system to include institutions with sufficient financial resources and expertise. The expanded PD system is expected to lower the borrowing cost of the government through greater competition. Accordingly in 2001, the Monetary Board decided, in principle, to permit LCBs to be appointed as PDs. Under the proposed new system, there will be two categories of PDs, namely, separate primary dealer companies and LCBs. An LCB that is appointed as a PD will be required to create and maintain a special reserve, known as the Primary Dealer Special Reserve (PDSR), to be used exclusively for investing the obligations arising from its PD activities. The minimum amount of the PDSR has been determined to be Rs.150 million, comprising at least two thirds of Tier 1 capital[1] and the balance upto one third of Tier 2 capital[2]. An LCB will also be required to conduct its PD business in a separate unit, headed by a manager holding a senior management position and maintain separate books of accounts in respect of its PD activities. The LCBs will be subject to prudential requirements relating to PDs and monitoring and supervision by the Central Bank.

The appointment of new PDs will be in terms of the regulations promulgated by the Minister of Finance under the provisions of the Registered Stock and Securities Ordinance (RSSO) and the Local Treasury Bills Ordinance (LTBO). These regulations will come into force during the early part of 2002.

In view of the diminishing opportunities for raising funds from international donor agencies due to competition from other developing countries coupled with difficulties in raising additional funds from domestic markets without causing an upward pressure on domestic interest rates, it became necessary to explore the possibility of raising funds from external sources. PDD on behalf of the Government issued two (2) year US Dollar denominated SLDBs amounting to US Dollars 158.5 million in three tranches in November and December 2001. The SLBDs were structured and issued within the borrowing limits for the year 2001.

The following categories of investors were eligible to purchase SLDBs.

(a) Authorised Dealers appointed in terms of Section 4 of the Exchange Control Act No. 24 of 1953.

(b) PDs appointed by the Monetary Board under the RSSO No. 7 of 1937 and the LTBO No. 8 of 1923.

(c) Citizens of foreign states whether resident in Sri Lanka or outside Sri Lanka.

(d) Citizens of Sri Lanka who have made their permanent abode outside Sri Lanka.

(e) Citizens of Sri Lanka who have proceeded outside Sri Lanka to take up employment or to set up in business or in a profession.

(f) Bodies corporate or unincorporate established under the laws of a country other than Sri Lanka.

The Cabinet of Ministers approved a foreign currency borrowing limit of US dollars 250 million for this purpose. The launching of the first ever offer of SLDBs took place on November 1, 2001. The first tranche of US Dollars 50 million (or Rs. 4,609.5 million) was issued on a first come first served basis with the value date of November 5, 2001. A further US Dollars 58.5 million (or Rs.5,395.4 million) was issued by way of a second tranche with the value date of November 15, 2001. Both these issues were made under the same Terms of Offer Document which included inter-alia, a 2 year maturity with a put option that could be exercised by the investors at the end of the first year and semi annual interest payments at the rate of 6 month London Inter Bank Offered Rate (LIBOR) plus 175

[1] Tier 1 Capital means the total of issued and paid up ordinary share capital, issued and paid up perpetual non-cumulative preference shares, share premium account, reserves created or increased by appropriations of retained earnings or other surpluses and less goodwill and other intangible assets, accumulated losses including losses on unaudited financial statements.

[2] Tier II Capital means the total of short term subordinated debt (maturity period of more than three years), long term subordinated debt (maturity period of more than five years), cumulative preference shares, and perpetual subordinated debt.

basis points for the first year and 6 month LIBOR plus 225 basis points for the second year. The third and the final tranche of SLDBs amounting to US Dollars 50 million (or Rs. 4,660.1 million) was issued with the value date of December 3, 2001 and maturity period of 2 years without the put option facility. The payment of interest will at 200 basis points over the 6 month LIBOR, semi annually. SLDBs are transferable by endorsement, delivery and registration with the Superintendent of PDD, Central Bank. The SLDBs are marketed through Designated Agents, ie, Authorised Dealers, in foreign exchange and PDs appointed by the Central Bank. SLDBs cannot be sold in USA or to persons resident in USA.

As a part of the information dissemination function, PDD continued to compile and publish daily and weekly reports on Government securities market, based on the data provided by PDs. While the daily report provides information on secondary market transactions, weighted average yield rates, two way quotes for Treasury bills and Treasury bonds, the weekly report provides statistics on the primary market as well as secondary market transactions. The daily & weekly reports are published in the newspapers and disseminated to the public through the electronic media: CBSL Web Page and the Reuters Information Service.

Directions to PDs to strengthen their compliance with prudential requirements and constituting the supervisory framework were drafted during the year in order to promote an efficient, transparent and a sound PD system, and to safeguard the rights of investors in government securities. These directions require the " Segregation of PD Accounts into Trading and Investment Securities Accounts" and also require PDs to revalue securities based on market prices, prepare and publish "Financial Statements", and also cover "Custodial Arrangements" relating to securities held by the PD on behalf of the customer. The directions came into effect in January 2002.

In order to promote best practice and to standardise documentation on market transactions, PDs were required to formally adopt a Master Repurchase Agreement (MRA) which is based on international standards. This agreement will be used in all repurchase transactions of Government securities entered into by PDs. It is expected that banks will also adopt the MRA.

Regular meetings with PDs continued on a weekly basis to discuss issues pertaining to the government securities market and to engage in a constructive dialogue between market participants and the Bank officials. Several "Investor Awareness Programmes" were organised by PDD and PDs, many of which were conducted in the regions.

PDD also re-organised its operations in accordance with modern internal control and risk management practices by dividing its activities into a Front Office (FO), Middle Office (MO) and Back Office (BO). The FO activities include conducting auctions and the issue of securities to the public. The MO handles the formulation of borrowing strategies, risk management and the maintenance of the public debt data base, whilst the BO is involved in debt service payments and settlements.

Operational Activities

The total outstanding gross public debt serviced by PDD as at end 2001 amounted to Rs.1,340,192 million. This indicated an increase of Rs.184,352 million or 16.0 per cent when compared with that of end 2000. The composition of public debt outstanding as at end 2001 included Rs.693,000 million (51.7 per cent) of domestic debt and Rs.647,192 million (48.3 per cent) of foreign debt. The domestic component of public debt increased by Rs. 89,974 million (14.9 per cent) while foreign debt rose by Rs. 94,378 million (17.1 per cent) over those of 2000. Table II - 15 shows the composition of public debt serviced by PDD.

TABLE II – 15
Composition of Public Debt

Category	At end 2000 Rs. Mn.	%	At end 2001 Rs. Mn.	%
Domestic Debt	603,026	52.2	693,000	51.7
Treasury bills	134,996		170,995	
Rupee loans	263,888		292,813	
Treasury bonds	204,124		229,174	
TCDs	11		11	
TRCs	7		7	
Foreign Debt (a)	552,814	47.8	647,192	48.3
Total	1,155,840	100	1,340,192	100

(a) Provisional Source : Central Bank of Sri Lanka.
Excluding IMF financial assistance and Loans to the Department of Railway.

Domestic Debt

Primary Market

Treasury Bills

The total Treasury bills outstanding as at end 2001 was Rs.170,995 million as compared with Rs.134,996 million at end 2000. This was the result of net new issues of Rs.36,000 million (i.e., new issues of Rs 45,100 million and retirements of Rs.9,101 million) during 2001. The authorised limit of Treasury bills was raised from Rs.135,000 million to Rs.175,000 million during the year.

The auctions were significantly oversubscribed as the total bids received during the year amounted to Rs. 325,134 million as against a total issue of Rs. 238,912 million. Of this, purchases by PDs amounted to Rs 115,149 million or 48.2 per cent of the total issues. Purchases by funds managed by the Central Bank amounted to Rs. 13,332 million accounting for 5.6 per cent of the Treasury bills issued, at the weighted average yield rates. The amount purchased by the Central Bank stood at Rs. 110,431 million or 46.2 per cent. Table II - 16 shows the maturity-wise distribution of sales of Treasury bills by source.

TABLE II - 16

Primary Issue of T-bills by Maturity and by Source – 2001

Source	Maturity (days) 91	182	364	Others	Total	%
1. Primary Dealers	45,097	7,358	62,694	-	115,149	48.2
2. CBSL	-	-	-	110,431	110,431	46.2
3. CBSL Managed Funds	6,707	365	6,260		13,332	5.6
Total	51,804	7,723	68,954	110,431	238,912	100.0

Source : Central Bank of Sri Lanka.

The number of Treasury bill certificates issued during 2001 was 115,391. This included 49,275, 14,823 and 51,293 of 91 day, 182 day and 364 day bills, respectively.

The weighted average yield rates by maturity in 2001 are given in Table II - 17, and corresponding rates for the previous four years are also given for comparison.

TABLE II – 17

Annualised Weighted Average Yield Rates of Treasury Bills

per cent per annum

Year	Maturity Period (Months) (a) 3	6	12	Overall Average
1997	11.03	11.95	12.29	11.60
1998	11.77	12.13	12.20	11.98
1999	11.69	12.03	12.55	12.06
2000	12.78	12.97	14.23	13.68
2001	16.11	17.33	18.41	17.41

Source : Central Bank of Sri Lanka

(a) The issue of Treasury bills with maturities of 91 days, 182 days, and 364 days in place of 3,6,12 month maturities respectively, commenced in October, 1999.

Rupee Loans

A total of 16 Rupee loans amounting to Rs. 51,000 million were floated during 2001. Of this, subscriptions received during the year amounted Rs. 50,910 million. As in the past, EPF, NSB and ETF continued to be the major subscribers to the Rupee loan programme in 2001, and these three institutions put together subscribed Rs.48,198 million, accounting for 94.7 per cent of the total subscription.

Rupee loans issued during 2001 carried interest rates of 13 per cent per annum for optional maturity period of 6-8 years and 15 per cent per annum for 2 year maturity and 2-5 year optional maturity. Three of these Rupee loans were floated with a fixed maturity of 2 years, eleven were floated with optional maturity of 2-5 years, and the other 2 issues were with optional maturity of 6-8 years. Information relating to flotation and repayment of Rupee loans in 2001 is summarised in Table II - 18

TABLE II - 18

Issue & Repayment of Rupee Loans - 2001

	Interest Rate % p.a.	Maturity (Years)	No. of Securities	Amount Rs. Mn.
Floated				
	13.00	6/8	2	4,410
	13.00	2/5	5	13,100
	15.00	2	3	19,500
	15.00	2/5	6	13,900
	Total		16	50,910
Repaid				
	10.00	10	1	1,500
	11.90	1	1	8,000
	12.00	2	3	7,486
	12.50	4	1	2,000
	13.00	4	1	3,000
	Total		7	21,986

Source : Central Bank of Sri Lanka.

A total of 7 Rupee loans, amounting to Rs.21,986 million, were repaid during 2001. Accordingly, net subscriptions to Rupee loans amounted to Rs. 28,924 million. This resulted in an increase in the outstanding liabilities on account of Rupee loans from Rs.263,888 million as at end 2000 to Rs.292,813 million at end 2001. The maturity profile of outstanding Rupee loans is provided in Table II - 19.

TABLE II–19

Maturity Profile of Rupee Loans (at end 2001)

Maturity (Years)	Amount (Rs. Mn.)	Percentage
2	19,500,000,000	6.66
2/5	27,000,000,000	9.22
4/5	5,500,000,000	1.88
4/6	10,316,677,500	3.52
4/8	3,500,000,000	1.20
5	10,000,000,000	3.42
5/6	17,000,000,000	5.81
5/7	53,715,010,400	18.34
6/7	33,800,000,000	11.54
6/8	5,410,000,000	1.85
7/8	26,400,000,000	9.02
8/10	24,210,594,000	8.27
9/8	1,000,000,000	0.34
1/10	19,392,620,000	6.62
9/10	7,500,000,000	2.56
10	4,479,862,000	1.53
30	24,088,000,000	8.23
Total	292,812,763,900	100.00

Source : Central Bank of Sri Lanka

Total interest payments on Rupee loans amounted to Rs.34,250 million in 2001, an increase of Rs. 348 million (1.0 per cent) over the previous year.

Treasury Bonds

During 2001, Rs.47,100 million of Treasury bonds were issued with maturity periods of 2 and 3 years. During the year, 40 auctions were conducted. This included 22 auctions for 2 year maturity, 17 auctions for 3 year maturity, and one auction for 4 year maturity. Although an outturn for 4 year maturity was conducted no bonds were issued.

In addition, four issues of 3 year Treasury bonds were made as private placements. The distribution of Treasury bond issues, by maturity, is given in Table II - 20 .

TABLE II–20

Issues and Maturities of Treasury Bonds - 2001

Maturity Period (Years)		Amount Rs.Mn	Percentage
Issues			
	2 Year	27,566	58.53
	3 Year	19,534	41.47
	Total	47,100	100.00
Maturities			
	2 Year	11,100	50.34
	3 Year	9,450	42.86
	4 Year	1,500	6.80
	Total	22,050	100.00

Source : Central Bank of Sri Lanka.

Following the downward revision of the Bank rate, repo rate and reverse repo rate by the Central Bank, effective from July 2001, interest rates on Rupee loans and the coupon rates of Treasury bonds were revised downward. The coupon rates of 2 year and 3 year Treasury bonds were reduced from 13.00 per cent per annum and 13.25 per cent per annum to 12.50 per cent per annum and 12.25 per cent per annum, respectively, in September, 2001. The coupon rates of all maturities ranging from 2 to 6 years were reduced by 25 basis points each. All auctions held during 2001 were over-subscribed with bids amounting to Rs.161,947 million. Table II - 21 provides information pertaining to the primary issues of Treasury bonds during 2001.

Interest payments are made semi-annually on the surrender of coupons to PDD by the Treasury bond holders through PDs. The total interest payments on account of Treasury bonds amounted to Rs.24,202 million in 2001, as compared with Rs. 15,015 million in the previous year.

Treasury bonds that matured in 2001 amounted to Rs.22,050 million. The number of Treasury bond scrips received for payment of maturity proceeds totaled 2,734. The total number of coupons received by PDD for coupon interest payments was 42,768.

The number of Treasury bond certificates issued during 2001 was 6,360. This included 5,652 of 2-year Treasury bonds and 708 of 3 year Treasury bonds.

Other Domestic Debt Instruments

There were no issues or payments of Treasury Certificates of Deposits (TCDs) and Tax Reserve Certificates (TRCs) during 2001. The outstanding amount of TCDs remained at Rs.10.6 million, while that of TRCs stood at Rs.7.2 million as at end 2001.

Secondary Market Transactions of Primary Dealers

A substantial volume of outright purchase and sale, repurchase and reverse repurchase transactions on Treasury bills and Treasury bonds took place among PDs and also between PDs and their clients. During 2001, the total outright sales and purchases of Treasury bills by PDs in the secondary market amounted to Rs.164,296 million and Rs.38,007million, respectively, while outright sales and purchases of Treasury bonds by the PDs amounted to Rs.49,067 million and Rs.24,857 million, respectively. The repo and reverse repo transactions of Treasury bills amounted to Rs.298,840 million and Rs.162,715 million respectively, while the repo and reverse repo transactions of Treasury bonds amounted to Rs. 481,869 million and Rs. 376,825 million, respectively. The decline in the outright purchases and sales, repurchases and reverse repurchases by PDs on Treasury bonds during 2001 was due

TABLE II –21

Selected Information on Treasury Bonds – 2001

Bond Title	Maturity (Years)	Bids Received (Rs. Mn.)	Bids Accepted (Rs. Mn.)	W.A.Y.R. to Maturity (% p.a.) (range)	Coupon Rate (% p.a.)
13.00%2003A	2	34,121.000	8,000.000	17.49-20.28	13.00
13.00%2003B	2	24,396.000	7,000.000	22.20-21.72	13.00
13.00%2003C	2	35,539.000	7,370.000	22.03-18.06	13.00
13.00%2003D	2	8,565.000	2,696.000	17.68-17.87	13.00
13.25%2004A	3	9,610.000	2,538.000	18.60-16.75	13.25
13.25%2004B	3	13,475.000	5,500.000	16.75-15.75	13.25
13.00%2003E	2	3,880.000	1,000.000	15.91	13.00
12.25%2004A	3	8,986.000	3,900.000	15.63-14.53	12.25
12.50%2003A	2	3,080.000	500.000	14.97	12.50
12.25%2004B	3	6,264.000	3,000.000	14.68-14.65	12.25
12.00%2005A	4	2,700.000	0	-	12.00
12.25%2004C	3	7,656.000	2,846.000	14.65-14.50	12.25
12.50%2003B	2	1,925.000	1,000.000	14.94	12.50
12.25%2004D	3	1,750.000	1,750.000	14.50	12.25
TOTAL		161,947.000	47,100.000		

Source : Central Bank of Sri Lanka

to a decrease in Treasury bond primary issues from Rs.125,322 million in 2000 to Rs.47,100 million in 2001.

As at end of 2001, stocks of Treasury bills held by PDs amounted to Rs.7,051 million or 4.1 per cent of the total outstanding, while Treasury bond stocks held by PDs amounted to Rs.10,516 million or 4.6 per cent of the total outstanding.

External Debt

The total outstanding external debt of the government as at end 2001 amounted to Rs.647,192 million, showing an increase of Rs.94,378 million (17.1 per cent) as compared with end 2000. Of the total outstanding debt as at end 2001, bilateral loans and multilateral loans amounted to Rs.303,912 million (47 per cent) and Rs.289,358 million (45 per cent) respectively, while commercial loans and export credit amounted to Rs.53,922 million (8 per cent). Major creditors in the bilateral category were Japan, USA and Germany. These sources accounted for Rs.276,796 million or 91 per cent of total bilateral loans. The International Development Association (IDA) and the Asian Development Bank (ADB), which were the major creditors in the multilateral category, were responsible for Rs.146,783 million (51 per cent) and Rs.136,001 million (47 per cent) respectively, out of the total multilateral debt.

When classified by the use of funds, project, programme and commodity loans amounted to Rs. 486,775 million (75 per cent), Rs.55,532 million (9 per cent) and Rs.28,271 million (4 per cent), respectively. Table II - 22 shows the composition of outstanding external government debt as at end 2001 by donor category and by use of funds.

TABLE II–22

Gross External Debt Outstanding (at end 2001(a)(b))

Category	Amount (Rs. Mn.)	%
1. Donor	647,192	100
Bilateral303,912	47	
Multilateral	289,358	45
Commercial	46,049	7
Export Credits	7,873	1
2. Use of Funds	647,192	100
Cash 39,461	6	
Commodity	28,271	4
Food 36,404	6	
Military 563	-	
Programme	55,532	9
Project 486,775	75	
Technical Assistance	186	-

(a)Provisional Source : Central Bank of Sri Lanka
(b)Excluding IMF financial assisstance and Loans to the Department of Railway.

The principal repayments and payment of interest plus other charges on external government debt in 2001 were Rs.32,203 million and Rs.11,532 million, respectively. The total disbursements during 2001 amounted to Rs.76,067 million, and this constituted Rs.24,706 million (32 per cent) from bilateral sources and Rs.11,969 million (16 per cent) from multilateral sources. Borrowing from commercial banks and export credit amounted to Rs.39,372 million (52 per cent). This compares with Rs.35,376 million of total disbursements which consisted of Rs.17,002 million (48 per cent) from bilateral, Rs.9,715 million (27 per cent) from multilateral and Rs.8,659 million (25 per cent) from commercial bank plus export credit, respectively, in 2000. The significant increase in commercial loan category is due to the loans raised through Bank of Ceylon and the issue of SLDBs during the year. Of the total disbursements during the year, 77 per cent was received under project loans, and 22 per cent in respect of cash loans. Table II - 23 shows the breakdown of disbursements by donor category and use of funds for 2000 and 2001.

TABLE II–23

Foreign Loan Disbursements

Category	2000		2001	
	Amount (Rs. Mn.)	%	Amount (Rs. Mn.)	%
1. Donor	35,376	100	76,067	100
Bilateral	17,002	48	24,706	32
Multilateral	9,715	27	11,989	16
Commercial	7,754	22	37,407	49
Export Credits	905	3	1,965	3
2. Use of Funds	35,376	99	76,067	100
Cash 7,754	22	37,407	49	
Commodity	15	-	190	-
Food 386	-	-	-	
Military	-	-	553	1
Programme	-	-	2,252	3
Project	27,221	77	35,665	47
Technical Assistance	-	-	-	-

Source : Central Bank of Sri Lanka

* Provisional
* Excluding IMF financial assisstance and Loans to the Department of Railway.

During the year under review, 29 new foreign loans were contracted and the number of operative loans increased to 541 by end of the year. These loans carried grace periods ranging from 0 to 17 years and repayment periods ranging from 1 to 40 years. Interest rates ranged from 0 to 10.85 per cent per annum. The grant element of the loans ranged between 2 and 94 per cent. Table II - 24 shows the ranges of grace period, maturity period, interest rate and grant element of the external government debt by donor category at end 2001.

TABLE II–24

Maturity, Interest Rates and Grant Element of External Debt

Donor Category	Maturity Period (Years)		Interest Rate/ Service Charge (% p.a.)	Grant Element (%)
	Grace Period	Repayment Period		
Bilateral	1 – 17	7 - 40	0.00 - 5.68	28 – 91
Multilateral	3 – 11	9 – 40	0.75 - 8.25	5 – 94
Commercial	0 – 10	1 – 30	4.00 - 10.85	2 – 65
Exports Credit	1 – 10	7 – 13	2.60 - 9.20	11– 74

Source : Central Bank of Sri Lanka

The Centre for Banking Studies

The Centre for Banking Studies (CBS) continued its training programmes for employees of the Bank and personnel in the financial sector to equip them with required skills to meet the challenges arising from technological advances and innovations in the financial sector. In 2001, the CBS conducted 58 training programmes, workshops and seminars for 1,247 participants covering 2,082 training hours. About 44 per cent of the participants were from the Central Bank. The rest were from commercial banks, specialised banks including regional development banks, finance companies, ministries and other financial sector institutions. Of the total number of training programmes conducted by the CBS, eight programmes were special programmes. Six of them were conducted exclusively for the officers of the Employees' Provident Fund Department, while the other two programmes were conducted at the request of the General Treasury and the Establishments Department of the Central Bank on 'Tax Reform in Sri Lanka' and 'Disciplinary Inquiry Procedures for Central Bank officers', respectively. Skills development in information technology, computer operations, office management, office procedures, and business communication were the main areas of the training courses conducted for officers of the Employees' Provident Fund Department.

As in the previous year, much emphasis was placed on training programmes on information technology and computer based applications. Sixteen training courses were conducted for a total of 203 trainees, of which 71 per cent were from the Central Bank. Of the computer training courses, 'An Introduction to Application Software', 'Computer Networking – Theory and Practice' and 'Computer Presentation with MS PowerPoint' evoked considerable interest among the participants. CBS commenced a new long term training programme for advanced computer users titled 'Advanced Course on Visual Programming'. This will be a stepping stone for Bank officers to obtain professional IT qualifications in the future.

CBS conducted thirty four short-term training programmes, seminars and workshops, covering subject areas such as banking operations, bank supervision, financial sector development, economic management, and management and skills development. The bank supervision courses recorded the highest rate of participation. Total number of participants was 252. 'Legal Aspects of Documentation for Advances' was the most attractive programme for banking and financial institutions. Other popular programmes were 'Non-Performing Assets (NPAs) and Banking System Failures', 'Sound Practices in Risk Management', 'Financial Frauds and Computer Crimes in Banks' and 'Prevention of Money Laundering – The Role of Banks'. As in the previous year, the bank supervision programmes were mainly attended by officers from the Central Bank, commercial banks, specialised banks and other financial sector institutions, which together accounted for 86 per cent of the total participation. The 'Hire Purchase and Lease Financing' programme was able to maintain the same popularity as in previous years. The other popular programmes were 'Lending on Pledge of Jewellery' and 'Evaluation and Administration of Development Credit'. The Centre for Banking Studies continued to offer its long-term academic programme on 'Certificate Course in Banking', in 2001.

Seven programmes were conducted to develop selected skills of Central Bank employees. These included programmes such as 'Skill Development Programme for Personal Secretaries/Personal Assistants and Steno-Typists', 'Presentation Skills' and 'Tender Procedures.' A specially designed programme was conducted for those who volunteered to retire from the Bank under the Voluntary Retirement Scheme announced in late 2001. The focus of this programme was to help retirees to fashion their life style after retirement. The workshops on 'Writing Better Reports' and 'Refresher Course for Junior Employees' were popular among personnel in the Bank and commercial banking sector. The 'Certificate Course in English Language' conducted by the CBS was yet another popular programme among the Central Bank employees.

Apart from conducting its own training programmes and seminars, the CBS provided logistical assistance to conduct 'High Level Training Programmes' co-ordinated by the newly established Management Development Centre (MDC) of the Central Bank. The MDC conducted 8 training programmes with

TABLE II – 25

Training Programmes conducted by CBS in 2001

	No. of Programmes	No. of Central Bank Trainees	No. of Other Trainees	Total No. of Trainees	Total Training Hours
Banking Operations	11	25	225	250	378
Bank Supervision	8	35	217	252	120
Financial Sector Development and Economic Management	5	31	95	126	54
Information Technology	16	144	59	203	864
Management	3	30	25	55	78
Skill Development	7	160	25	185	228
Special Programmes	8	122	54	176	360
Total	58	547	700	1,247	2,082

foreign and local resource persons on 'Financial Programming', 'Economic Growth: Facts, Theory and Policy Implications', 'Public Debt Management (Workshop)', 'Basle Core Principles for Effective Banking Supervision', 'Public Debt Management', 'Modern Central Banking', 'Management Development Programme' and 'Econometric Applications in Finance'.

The CBS, for the third successive year, continued its series of monthly public seminars and commemoration lectures to disseminate new ideas and provide a forum for the public, including professionals and academics, to exchange views and share experiences on issues pertaining to economic and financial sector developments. Four commemoration lectures were held in 2001. They were the Independence Commemoration Lecture delivered by Professor W.D. Lakshman, Professor of Economics and former Vice Chancellor of the University of Colombo on 'Development as a Holistic Process: Lessons from Last Five Decades', the Republic Commemoration Lecture delivered by Dr. Yaga V. Reddy, Deputy Governor of the Reserve Bank of India on 'Issues in Implementing International Financial Standards and Codes', the 51st Anniversary Lecture of the Central Bank of Sri Lanka (CBSL) delivered by Dr. P.B. Jayasundera, then Secretary of the Ministry of Finance and Planning and Secretary to the Treasury on 'Current Issues in Public Finance and the Future Direction of Fiscal Policy in Sri Lanka - Managing the Process', and the 20th Anniversary Lecture of the Centre for Banking Studies delivered by Professor Michel Gervais, former Inspector-General, Ministry of Agriculture, Paris and Professor of Agricultural Economics, National School for Veterinary Medicine, Paris on 'Food Security, Development and International Trade'.

Seven public seminars aimed at enhancing awareness among the general public on current economic policies and issues were conducted in 2001. The list of seminar topics and speakers are given below :-

(i) 'Floating of the Rupee Since 1978' by Dr. H.N. Thenuwara, Deputy Director, Economic Research Department, Central Bank of Sri Lanka.
(ii) 'The Minimalist State or the Developmental State?' by Professor Amia Kumar Bagchi, Reserve Bank of India and Professor of Economics, Centre for Studies in Social Science, Calcutta.
(iii) 'State of the Economy as Reflected in the Central Bank Annual Report and the IMF Report, 2000' by Dr. A.G. Karunasena, Director of Economic Research Department, Central Bank of Sri Lanka and Dr. Nadeem Ul Haque, Senior Resident Representative of the IMF in Sri Lanka.
(iv) 'Global Science and Third World Pygmies' by Dr. R.O.B. Wijesekara, Chairman, National Science and Technology Commission, Sri Lanka.
(v) 'Measures to Revive the Stock Market' by Mr. Hiran Mendis, Director General, Colombo Stock Exchange, Sri Lanka.
(vi) 'Reforms of Higher Education in Sri Lanka' by Professor B.R.R.N. Mendis, Chairman, University Grants Commission, Sri Lanka.
(vii) 'Globalisation and the Nation State' by Mr. Winston A. Cox, Deputy Secretary-General, Commonwealth Secretariat, London and former Governor, Central Bank of Barbados.

Secretariat

The Secretariat Department continued to provide corporate services such as finance, procurement, travel and other miscellaneous services in addition protocol services of the Bank.

The system of monitoring of departmental expenditure in relation to the approved capital and administrative budget of the Bank, with a view to enhancing efficiency and cost effectiveness, was further strengthened in 2001 by issuing guidelines on steps that should be taken to ensure that the Bank functions in accordance with management objectives.

Legal

The Legal Department advises the Bank on legal issues, and represents the Bank in courts and in other legal fora. It contributes to the development of laws in the banking/financial sector.

As in previous years, the Department continued to provide advisory services to the other departments of the Bank. During the year 2001, the department was involved in legal work related to the mondernisation project of the Bank, including the modernisation of the payment and settlement system and the government securities settlement system.

Premises

The Premises Department continued to carry out the maintenance and upkeep of the Bank's own premises and premises taken on lease during the year 2001. The Department also continued to provide support services to other departments of the Bank, such as transport and communication facilities.

The work of the New Buildings Department was transferred to the Premises Department on 3 September 2001 and the New Buildings Department ceased to function from that date. Hence, the Premises Department had to attend to additional functions such as the monitoring and supervising of work connected with landscaping and maintaining the various installations the Bank's headquarters building complex.

The rehabilitation of the damaged towers of the Bank building was completed in May 2001 and office space in those towers was provided in July 2001 to Departments which were until then accommodated in leased premises and in the building complex of the Centre for Banking Studies at Rajagiriya. The Department also continued to supply modern office furniture to the departments.

Planning work for the construction of a car park on land leased for the purpose from the Urban Development Authority continued. Construction work on an inspection bay with facilities to examine cargo brought into the Bank building commenced in July 2001.

The Department continued to maintain the Light House Clock Tower on Chatham Street.

Security Services

The Department continued to take all precautionary measures and worked very closely with the government security establishments and intelligence agencies to ensure safety of the employees and the assets of the Bank. To further strengthen the security measures an entry card system to prevent any unauthorised persons entering the Bank premises was introduced.

Two baggage/mail scanners are positioned at the entrance, so that the bags of all persons entering the Bank are checked. In addition, explosive detectors are kept ready to check any suspicious objects detected in the baggage scanning screen. A vehicle inspection bay is under construction where all vehicles will be checked thoroughly before entering the Bank premises. A heavy baggage scanner will be installed in the inspection bay to check baggage and cash transport vehicles before entering the premises.

Fire equipment and fire hydrants are checked constantly to ensure efficient functioning, and employees are regularly trained on fire evacuation drills. A major combined fire evacuation drill was practised in liaison with the Colombo Fire Brigade with their special high rise emergency evacuation machines in place.

Fire-power of the security personnel has been further strengthened with the introduction of new and effective fire arms.

Information

The Information Department of the Bank continued to function as the Central Information Unit of the Bank, responsible for collection and dissemination of information to bank personnel and to the public through multi-media.

During the year, the department commenced publication of a new in-house bulletin named "Kauluwa" (Window) replacing the "Internal Newsletter" which served to disseminate management and general information within the bank since 1996. The new publication provides an avenue for two-way communication between the employees and the management which is particularly useful in implementing the modernization programme of the Bank. During the year, nine issues of Kauluwa were released.

The dissemination of information to the outside world was carried out through both electornic and print media. Daily exchange rates, weekly and monthly economic indicators, consumer price indices, information on treasury bills and treasury bonds were published regularly. In addition, official press releases were undertaken by the department. The department also handled publicity and advertising work of the bank.

The department, on behalf of the Bank, printed its regular publications during the year. These include the Annual Report, Sri Lanka Socio-Economic Data, the Monthly Bulletin, and Economic and Social Statistics of Sri Lanka. One issue of Staff Studies, eight issues of Satahana (Sinhala) and six issues of News Survey (English) were also released. Heritage of Ruhuna "Ruhunu Preveniya" (Sinhala version of Heritage of Ruhuna), Theories of International Trade (Sinhala), Recent Economic Developments, History of Coins and Currency in Sri Lanka (reprint) and second revision of the "Laws Relating to Banking and Finance in Sri Lanka" were the special publications issued during the year.

The printing press, as in the previous year, continued to fulfil the printing requirements of the Bank. Along with the printing of the above mentioned publications, the printing press undertook 250 printing assignments during the year under review. Apart from them, eight publications for the Ministry of Finance were also undertaken by the printing press. The department continued to provide photographic and artistic design services to the Bank.

Library & Information Centre (LIC)

During 2001, the rebuilding work of LIC which had been destroyed in the 1996 attack on the Bank was continued, with the acquisition of more equipment, books/CD ROMs and special furniture. This considerably improved the services provided by LIC.

In March, the Sub-library which was functioning under the Centre for Banking Studies (CBS) was amalgamated with LIC, facilitating the introduction of a centralized ordering, cataloguing and a classifying system for both libraries.

During the year under review, the LIC continued to compile electronic publications such as Web News, Recent Additions, Current Contents, BIS Review, Current Article Abstracts, Central Banking Around the World, Banking & Finance Around the World and disseminated current information via intranet. Also, foreign news and articles have been repackaged daily by the "News Clips" service.

In 2001, the collection of the main library was increased to 10,107 books and 762 CD ROMs, while subscriptions were made for 220 periodical titles with online access to 4 of them. Also the book collection of the CBS Library was increased to 4012.

During the year, LIC strengthened its ties with Central Bank Libraries around the world by joining the Central Bank Library Network of Central Banking Publications (Ltd.), UK, and made use of the facility to enhance the information services.

As a part of skills development of Bank's officers, 3 video presentations on office managerial issues for different user groups were made during the year. At the end of the year, a videoconference was organized by LIC in collaboration with the information specialists of World Bank/IMF, and shared the key issues of the Central Bank Librarians' Workshop held in August 2001 at IMF with the LIC staff and local bank librarians as well.

Information Technology

Responding to the progress in information processing technology, the IT facilities in the Bank were expanded further, enabling all departments to perform their functions in a computerised environment, conducive for promoting efficiency and reducing operational costs. The main focus of the department was geared to (a) introduce new technology, (b) upgrade the existing computer systems to provide a consistent and reliable service to all departments, (c) expand the computer network to streamline communication through e-mail and for information sharing, (d) to improve the skills of the departmental IT staff. These were undertaken with a view to preparing the IT environment of the Bank to meet the future challenges in keeping with its long-term vision.

Steps were taken to provide the AS/400 service without any interruption by strengthening supportive facilities such as uninterrupted power supply (ups) and regular checks on the early warning system, to prevent incidents of service breakdown. A backup site for the AS/400 system was setup and was brought into operation with a dedicated leased line facility to back-up data and software from the servers to the back-up computer at the end of the day. This is undertaken as a means of disaster recovery, to shift the critical operations to the back-up site in the event of a major breakdown or a disaster.

The Local Area Network (LAN) was expanded, connecting 335 personal computers located in all 5 wings of the Central Bank Building. The operations of the LAN have helped to streamline the internal and external communication of employees through e-mail. The e-mail facility has been provided to 405 officers. Internal circulars and memos are replaced gradually by e-mail, helping to economise on paper flow, reducing photo copying costs and the manual effort to deliver circulars/memos. This has also resulted in sharing of computer resources among users.

The Internet facility has been made available to all Heads and Additional Heads of Department. A common facility is provided for the staff to access the Internet from computers located in a public area at the information centre. With the introduction of these facilities, the CBSL computer network became open to the outside world, which required protection from hackers, viruses and other malicious content. Therefore to secure the network, a network management system was installed.

The Network Management System has the facility to manage and monitor network components to ensure availability, optimal performance and reliability from a central point. It also provides a physical map of the entire system, alerts the end-user to problems and prevents access to unauthorised or unproductive web sites.

The firewall facility will prevent hackers gaining entry to the network, users gaining access to unauthorised areas, intervene, detect, block and notify all types of malicious content viruses and data and e-mail encryption facility. The anti-virus software 'InoculateIT' will protect the system by detecting and curing potentially damaging viruses.

The Information Technology Department (ITD) of the Bank has contributed towards disseminating information through the Web site to a wider population by developing the contents of the Central Bank Web site in the Sinhala language and the EPF Web site, which will be implemented during the first quarter of 2002. The internal Web site introduced by ITD has the facility to access personal information (Salary, Provident Fund and Loan balances) of employees and will be expanded into other areas.

ITD continued to maintain the EPF application system and further automation was undertaken during the year under review. With the shifting of the EPF Department from Renuka building to the Central Bank Head office building, the computer network of EPF was expanded to facilitate AS/400 terminals as well as personal computers with leased lines connections to Labour Department and Inquiries counter at Renuka building. A computerised bank reconciliation system was implemented with the facility of directly uploading the bank statements that are received through e-mail. Several monitoring systems were also implemented to identify employers defaulting EPF payments. A Web site was also developed to disseminate general information to members of the fund. This will be expanded to provide member balances and to accept C/C1/C3 forms from employers. ITD also continued providing information to Labour Department on EPF matters. These facilities were provided by ITD in addition to the overall maintenance of the EPF computer installation.

ITD examined the staff payment modules with a view to improve systems, in line with the changes in requirements from the user departments. Modules relating to staff loans tracking and payroll computations in the IHRM Software Package, were further customised to suit the requirements of the respective user departments, namely the Welfare Department and the Finance Department.

Systems for the following purposes were implemented, using the wide area network connecting the head offices of all commercial banks and primary dealers to the Central Bank

- To conduct the primary auctions in government debt securities.
- To obtain two-way quotes of US dollar/SL rupee exchange rates in commercial bank foreign exchange operations.
- For banks to report to the Central Bank on the movement of funds in SIERA Accounts.

- For communications related to supervision and surveillance of banking and primary dealer operations
- Electronic bidding at primary auction for Treasury bills and bonds

ITD continued to develop several AS/400 based and PC based applications for the user departments of the Bank. A facility for the Currency Department to enter voucher entries that are generated for current accounts, a dealer information system for the Banking Department, a pension fund monitoring and investment system, Advance account settlement system and supplies inventory control system for the Secretariat Department were implemented. Computerisation of the General Services Division of the Secretariat is in progress. A Welfare Loan Granting System was also implemented on a test basis.

The ITD has made a significant contribution to the Central Bank's strengthening projects, mainly in the reform of the payments system. The IT staff worked closely with the consultants and played an active role within the RTGS task force in preparing the bidding documents which has been accepted by the World Bank.

The Sri Lanka Automated Clearing House continued to operate the system for the inter-bank exchange and clearing of cheques. The number of cheques cleared in 2001 increased by 2.14 per cent to reach 35.31 million. The average value of payments handled during the year was Rs.9.92 billion per business day, totaling to Rs.2,371.91 billion for the year. Following the trend in recent years, the volume of SLIPS transactions increased rapidly during the year, recording a growth of 17.01 per cent. The value of SLIPS transactions processed during the year was Rs.1,667.12 Billion, compared to Rs. 1,245.83 billion in 2000.

In view of the rapid growth in SLIPS transactions, a software upgrade was done, which resulted in reducing the processing time by 50 per cent. A continuous improvement was shown in the direct debit transfer system, with several private companies and banks increasingly using the system to collect their bills and credit card payments.

During the year under review, significant progress was made towards the divestment of SLACH so that the participants in clearing could run it as an efficient venture, while introducing the latest technology. The due-diligence study and the valuation of assets of SLACH were completed, and the Memorandum and Articles of Association of the new company to take over the functions of SLACH were prepared. The allocation of shares in the company will be on the basis of 48 per cent to the state banks (including the Central Bank) and 52 per cent to the private commercial banks. The divestment was to be completed and the new company LANKACLEAR (Pvt.) Limited commenced its operations from 1 April 2002.

Management Audit

In keeping with the Annual Audit Programme, the Management Audit Department carried out its internal audit and management services functions during the year 2001 with the objective of increasing the efficiency, economy and effectiveness in the performance of the Central Bank's functions.

An Audit Committee of the Monetary Board was established during the year 2001 in order to improve management practices and the financial procedures of the Bank. The Audit Committee will, among other things, oversee the audit process, the financial statements of CBSL, the related financial reporting practices and the system of internal controls.

The internal audit charter was adopted in 2001, which empowered the Department to carry out reviews of existing systems and procedures throughout the Bank more independently.

During the year, the Department audited unserviceable and damaged currency notes to the value of Rs.66 billion of various denominations prior to their destruction, and supervised the work at the Currency Verification, Counting and Sorting (CVCS) Unit. The Department also carried out the annual verification of stocks of currency notes and coins. The Stock Registers of currency were checked and certified by the audit officers after reconciling receipts and issues.

Pre-auditing was carried out on all payments relating to the construction and rehabilitation of the Head Quarters building of the Bank. In addition to auditing of all emoluments paid to Bank employees, including the terminal benefits, the annual financial statements prepared by the Secretariat and Welfare Departments relating to the Pension Fund, Provident Fund, Widow's and Widower's Pension Funds and other welfare schemes of the Central Bank were pre-audited. Further, refunds on retirement or on terminating services with the Bank and compensation paid to the employees who retired under Voluntary Retirement Scheme (VRS) were pre-audited by the Department.

The Department also continued to pre-audit all refunds made to the beneficiaries of Employees' Provident Fund (EPF) and also audited the statements of annual accounts of the EPF. The Department also carried out several management studies with a view to improving the efficiency and effectiveness of the Bank.

Training

Human resource development being a priority objective of the Bank to upgrade the quality of its staff, the Bank continued to train its staff at all levels by providing opportunities to undergo training in both local and overseas training programmes. As in previous years, the Central Bank sponsored training of suitable officers mainly in the fields of economics, banking, finance, money and capital markets, information technology etc. in short term and long term programmes. The Training Department carried out these training activities as the coordinator of the training functions in the Bank. Under the Bank's restructuring programme, training was identified as a key area and three Task Forces were appointed to study the training needs and recommend suitable action to strengthen the training activities of the Bank. The three task forces were required to report on the following:

1. Identification of postgraduate training requirements, the areas of training and appropriate institutions;
2. Development of a training plan and formulation of criteria for selection of participants for training programmes; and
3. Developing criteria for allocation of trainees to train others, follow up of trainees in order to improve their skills and capacities in relevant fields and strategies for effective utilisation of the skills and knowledge.

Based on the findings of the task forces, a five year action plan is to be formulated to carry out the future training activities of the Bank commencing early 2002.

With regard to postgraduate studies, the Bank recognized that such studies should not be confined to economics, but should be extended to cover other areas of study such as banking, law, management and information technology.

At end 2001, 12 officers were pursuing postgraduate studies abroad. During the year, one officer completed Ph.D. studies and 7 officers returned after completing Master's degrees.

Bank's officers were sent for short term training courses held both locally and abroad in various fields relating to banking, finance, management etc. During 2001, a total of 497 officers participated in local training courses mainly conducted by the Centre for Banking Studies of the Central Bank. The number trained in short term courses abroad was 86.

Special seminars were conducted for Bank's officers to upgrade their knowledge on subjects such as auditing, insurance and bank supervision. In addition, a weekly seminar series was conducted by the Department with the objective of imparting knowledge on current economic, banking and other general issues. These Seminars were conducted by eminent persons from other institutions in Sri Lanka and abroad, as well as by officers of the Bank. During the year, 54 such seminars were conducted.

Welfare

The Welfare Department while attending to the routine activities of the Department such as the implementation of the staff loan schemes and other staff welfare facilities, sought to reorient its out look in providing such facilities with a view to improving the working environment in the Bank. Thus, the Department organised a series of lectures by eminent medical personnel on "Employee Well Being", to improve the knowledge of the employees on subjects such as 'Avoidance of Stress', and on common diseases such as diabetes, hypertension, etc. The services of the bank clinic with a full time medical officer in attendance, continued to be made available to the bank staff.

The refurbishment of the staff canteens in the Bank were completed and with effect from 6 August 2001, arrangements were made to provide wholesome meals to the employees in a pleasant environment. The Bank's canteen also commenced the provision of tea at the desks of the employees. Hence supply of tea to employees by a private contractor was terminated. Provision of meals to the participants of many official functions such as international seminars and conferences were also undertaken by the canteen, thus ensuring a reduction in cost.

A loan scheme for the purchase of computers hitherto available to staff officers only, was made available to all employees of the Bank. The Department also examined improvements to the Medical Benefit Scheme for employees.

As a measure of assistance to employees who suffered serious eye injuries when the Bank was attacked in 1996, and retired from Bank service, the Monetary Board approved the provision of computer facilities with Scanner and Optic Character Recognition and Job Access Working System Software to such employees to enable them to read and write and thereby improve their quality of life.

Arrangements were made with the Insurance Corporation to provide a Loan Protection Policy for employees who obtained housing loans from the Bank. In terms of these policies, the dependants of the policy holders would not be burdened with the housing loan debt, in the event of the demise of the employee before reaching the age of 70 years.

Management Development Centre

The Management Development Centre (MDC) was established in April, 2001, with responsibility for conducting high level training programs with a view to improving the professional skills and updating the knowledge, especially of senior staff of the Central Bank. The services of MDC were also made available for training officers of the Ministry of Finance, research organisations and other financial institutions.

The MDC conducts a regular series of training programs for the Bank's senior officers in areas relevant to their work in the Bank, such as monetary theory, financial sector stability, exchange rate policy, etc.

At present, the high level training programme is fully funded by the Swedish International Development Cooperation Agency (SIDA) under a technical assistance grant to the Central Bank. In order to give a good exposure to both the theoretical and practical aspects of training to the participants, resource persons were drawn from experts in the relevant subjects from universities of international repute and in from other such organisations. Some courses are jointly conducted by foreign and local resource persons.

During the year under review, nine high level training programs were conducted by MDC, of which, six were 1-2 week courses, two were one day workshops, and one a 10 day Management Development Programme (MDP) (Table 1). The MDP course, which is similar to the Management Development

TABLE II - 26

High Level Training Programmes Conducted During 2001

NO.	COURSE TITLE	DURATION	RESOURCE PERSON/S
1	Financial Programming	09-18May (09 days)	(1) Dr.Mohammed Zubir Khan, Managing Director, Financial Techniques International Pakistan (2) Dr. Ashok K. Lahiri, Director National Institute of Public Finance and Policy, India.
2	Economic Growth: Facts, Theory and Policy Implications	14-22 June (07 days)	Professor Jisoon Lee, Professor of Economics Seoul National University, South Korea.
3	One Day workshop on "Issues Related to Public Debt Management"	27,July	Mr Nihal Kappagoda, Economic Consultant and Local Resource Persons
4	One Day workshop on "Basel Core Principles for Effective Banking Supervision	17, August	Local Resource Persons
5	Public Debt Management	05-16 November (10 days)	(1) Mr. Nihal Kappagoda, Economic Consultant (2) Dr. T.R.Anathakrishnan,Financial Consultant
6	Introductory Course on Risk Management in Banks and Financial Institutions	06-09 November (04 days)	Local Resource Persons
7	Modern Central Banking	21-28 November (06 days)	(1) Professor Andres Vredin, Head, Research Department The Central Bank of Sweden (2) Professor Staffan Viotti, Senior Advisor to the Governor The Central Bank of Sweden
8	Econometric Applications in Finance	10-21December (10 Days)	Professor Melvin Damian Ayogu University of Cape Town, South Africa
9	Management Development Programme	10-21December (10 Days)	(1) Professor D.S.Withane,Head Management and Labour Studies, University of Windsor (2) Professor Francis Rieger, Associate Professor of Management, University of Windsor.

Programme conducted by the Asia Pacific Rural and Agricultural Credit Association (APRACA) was developed in consultation with resource persons from the Department of Management and Labour Studies, Odette School of Business, University of Windsor, Canada, to suit the requirements of the Central Bank. This programme was designed to strengthen strategic thinking, organisational analysis and human resource development skills of senior executives of the Central Bank and the Ministry of Finance.

Personnel

The Establishments Department performed functions with regard to staff recruitment, appointments, promotions, retirements and other related matters during 2001 in keeping with its vision of "maintaining a competent and capable work force developed to its true potential, with an ability to clearly understand their role and responsibilities and discharge them efficiently and effectively and meet un-hesitantly the emerging needs and challenges".

During 2001, Brigadier Gamini Angammana was recruited to the Bank service, on contract, as Director of Security Services. Action was initiated in the latter part of this year to recruit staff officers to the Bank service, and it is expected to finalise recruitment during the first half of 2002. Action was also initiated to make appointments to the posts of Director of Human Resources, Director of Management Audit and Chief Accountant on contract basis.

The Governor, Mr A.S. Jayawardena, attended the following meetings during 2001.

1. Euroclear Bank Meeting with a Sri Lankan Delegation led by H.E. the President, held in Belgium from 18-19 March and visit to Luxembourg from 20-22 March.
2. 2001 Bank/Fund Spring Meetings held in Washington, D.C. from 23 April to 2 May.
3. Asian Clearing Union General Meeting held in Myanmar

from 28-31 May; Annual South East Asian Central Bank (SEACEN) Governors' Meeting held in Singapore from 1-2 June; Commonwealth Central Bank Governors' Meeting on Corporate Governance for the Banking & Financial Sector held in London from 5-6 June; Bank of England Annual Central Bank Governors' Symposium held in London from 7-8 June and the Bank for International Settlements AGM held in Basle from 9-11 June.

4. Project Lion Road shows in Singapore and Hong Kong from 3-6 July.
5. G-24 Meetings held in Paris from 13-14 November and visit to Belgium from 15-16 November.

Amalgamation of Functions of the New Buildings Department with the Premises Department

The functions and duties carried out by the New Buildings Department were transferred to the Premises Department and accordingly, the New Buildings Department ceased to function with effect from 3 September 2001.

The Financial Markets Department also ceased to function with effect from 4 September 2001.

Voluntary Retirement Scheme (VRS)

Central Banks all over the world have undergone radical changes in recent times. In order to meet the changing needs, the Central Bank felt the need to reorganise functional areas with the objective of attaining the highest level of efficiency, by increasing productivity and excluding activities which are not directly related to the core functions of the Central Bank. Hence, it became necessary to outsource certain activities to specialised institutions outside, to secure a better service and also to reduce the operational costs of the Bank.

In the face of these changes, the Bank felt the need to reduce its staff by providing an opportunity to employees who may feel that adjustment to a more competitive and demanding environment in the current stage of their career is burdensome, and to others who may have family and other outside commitments which need their attention and also to those who may feel that they have better prospects and opportunities elsewhere, to retire prematurely from Bank service under a Voluntary Retirement Scheme, subject to exigencies of service of certain categories of employees.

The Trade Unions of the CBSL had also made representations to the management to obtain an early retirement scheme. The Bank, therefore, initiated action for the implementation of a VRS in the year 2001, with World Bank assistance, which provides an opportunity of early retirement to eligible employees.

The scheme was circulated among all employees on 1 October 2001 and eligible employees were given 1 1/2monthstime to communicate whether they would opt for early retirement. In response, 713 employees, consisting of 148 Staff Officers, 426 Non Staff Officers and 139 Minor Employees applied for early retirement. Of the 713 employees, 690 were qualified to receive VRS benefits, while 23 were not eligible.

With the implementation of VRS 690 employees comprising 141 Staff Officers, 416 Non Staff Officers and 133 Minor Employees have benefited from the scheme while the Bank was able to downsize its staff strength from 1,908 to 1,218.

Appointments

1. Mrs. M. A. R. C. Cooray who was on release to the Ministry of Finance and Planning as Director General/ Fiscal Policy and Economic Affairs, reverted to the Bank service on part time basis, and was promoted to the Special Grade and designated as an Assistant to the Governor with effect from 17 July 2001.
2. Dr. (Mrs.) R. Jayamaha who was on release to the Commonwealth Secretariat, London, reverted to the Bank service, and was promoted to the Special Grade and designated as an Assistant to the Governor with effect from 17 July 2001.
3. Mrs. L. K. Gunatilake, Acting Director of Supervision of Non Bank Financial Institutions Department was appointed as Director of Supervision of Non Bank Financial Institutions Department with effect from 1 January 2001.
4. The following appointments were effected from 20 April 2001.
   i Mr. T. S. N. Fernando, Superintendent and Registrar of Public Debt Department as Director, Management Development Centre.
   ii Mr. J. M. T. B. Jayasundara, Director, Premises Department as Director, Information Department.
   iii Mr. K. G. D. D. Dheerasinghe, Additional Superintendent of Public Debt Department as Superintendent and Registrar of Public Debt Department.
   iv Mr. G. A. V. Fonseka, Acting Additional Director, New Buildings Department as Acting Director, Premises Department.
   v Mr. C.K. Paranavithana, Director, Information Department as Acting Director, Management Audit Department.
5. Brigadier Gamini Angammana was appointed as Director, Security Services Department with effect from 1 August 2001.
6. Dr. H.N. Thenuwara was appointed as Acting Additional Superintendent of the Public Debt Department with effect from 15 August 2001 on a part time basis.
7. Mr. K. A. D. Rupasena, Additional Director of Establishments Department was appointed as Acting Director of Establishments Department with effect from 3 October 2001.

Retirements

1. Mr. M. I. F. Hamid, Director, Supervision of Non Bank Financial Institutions Department, retired from the Bank service w.e.f. 1 January 2001.
2. Dr. N. L. Sirisena, Director, Centre for Banking Studies retired from the Bank service w.e.f. 1 January 2001.
3. Mr. M. R. Fernando, Superintendent of Currency Department retired from the Bank service w.e.f. 11 January 2001.
4. Mr. M. S. Siripala, Director, Management Audit Department, retired from the Bank service w.e.f. 1 August 2001.
5. Mr. M. Ramanathan, Director, Development Finance Department, retired from the Bank service w.e.f. 1 September 2001.
6. Mr. K. C. M. Gunasekera, Director, Training Department, retired from the Bank service w.e.f. 15 September 2001.
7. Mr. M. B. Dissanayake, Assistant to the Governor, retired from the Bank service w.e.f. 17 October 2001.
8. Mr. S. Pattiwidana, Executive Director, retired from the Bank service w.e.f. 29 October 2001.
9. Mr. T. S. N. Fernando, Director, Management Development Centre, retired from the Bank service w.e.f. 12 November 2001.

Brig. H. S. A. Perera, Director, Security Services Department and Mr. A. R. M. Mihindukulasuriya, Director, New Buildings Department relinquished office w.e.f. 31 August 2001 and 3 September 2001 respectively, on expiry of their service contracts with the Bank.

Officers on Release

1. Mrs. M. A. R. C. Cooray to the Ministry of Finance as Director General/Fiscal Policy and Economic Affairs (part-time).
2. Mr. R. A. Jayatissa to the International Monetary Fund as Alternate Executive Director.
3. Dr. U. Vidanapathirana to the Ministry of Industries as Secretary.
4. Mr. M. J. S. Abeysinghe to the Ministry of Finance.
5. Mr. R. Akurugodagamage to the Ministry of Finance.