

## **PART II**

## PART II

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

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**1. ACCOUNTS AND FINANCE****CENTRAL BANK OF SRI LANKA****Balance Sheet  
As at 31 December**

	Note	2007 Rs. '000	2006 Rs. '000
<b>Assets</b>			
<b>Foreign Currency Financial Assets</b>			
Cash & Cash Equivalents	1	160,051,979	105,601,686
Financial Assets:			
-Securities at Fair Value through Profit or Loss	2	113,583,131	107,413,474
-Securities Denominated in Gold at Fair Value through Profit or Loss	2	13,991,886	11,905,227
-Available for Sale Investments	2	79,541,928	68,211,989
IMF Related Assets	3	71,899,462	67,276,214
Other Foreign Receivables		767,873	155,840
<b>Total Foreign Currency Financial Assets</b>		<b>439,836,259</b>	<b>360,564,430</b>
<b>Local Currency Financial Assets</b>			
Investment Portfolio - Sri Lanka Government Securities		43,612,184	67,507,503
Advances to Government	4	60,679,200	49,015,400
Loans to Other Institutions	5	2,093,650	2,487,446
Other Local Receivables		706,767	1,173,461
Investments in Financial and Other Institutions	6	50,135	45,185
Other Assets		1,230,688	600,997
<b>Total Local Currency Financial Assets</b>		<b>108,372,624</b>	<b>120,829,992</b>
<b>Total Financial Assets</b>		<b>548,208,883</b>	<b>481,394,422</b>
<b>Other Assets</b>			
Inventories	7	1,665,348	2,267,537
Gold Inventory being refined		59,766	59,766
Sundry Assets		2,155,045	1,957,404
Property, Plant and Equipment	8	9,354,648	7,171,183
Intangible Assets	9	953	-
<b>Total Other Assets</b>		<b>13,235,760</b>	<b>11,455,890</b>
<b>Total Assets</b>		<b>561,444,643</b>	<b>492,850,312</b>
<b>Liabilities and Equity</b>			
<b>Liabilities</b>			
<b>Foreign Currency Financial Liabilities</b>			
Amounts Payable to Banks and Financial Institutions	10	6,730,522	10,134,724
Amounts Payable to Asian Clearing Union		48,454,327	33,477,598
IMF Related Liabilities	11	102,291,389	97,032,223
Other Foreign Payables		1,615,652	1,544,545
<b>Total Foreign Currency Financial Liabilities</b>		<b>159,091,890</b>	<b>142,189,090</b>
<b>Local Currency Financial Liabilities</b>			
Deposits by Banks and Financial Institutions	12	91,053,024	82,615,387
Balances with Government and Governmental Entities	13	1,416,075	1,356,351
Securities Sold Under Agreements to Repurchase		18,000	562,000
Balances with Employee Benefit Plans	14	2,250,165	2,754,936
Other Payables		1,923,545	1,231,476
<b>Total Local Currency Financial Liabilities</b>		<b>96,660,809</b>	<b>88,520,150</b>
<b>Total Financial Liabilities</b>		<b>255,752,699</b>	<b>230,709,240</b>
<b>Other Liabilities</b>			
Currency in Circulation		173,363,722	157,239,605
Deferred Grants		68	59,985
Pension and Other Post Employment Benefit Plans		324,183	1,121,818
Miscellaneous Liabilities and Accruals		614,604	370,149
<b>Total Other Liabilities</b>		<b>174,302,577</b>	<b>158,791,557</b>
<b>Total Liabilities</b>		<b>430,055,276</b>	<b>389,500,797</b>
<b>Equity</b>			
Contributed Capital	15	15,000	15,000
<b>Reserves</b>	15	<b>131,374,367</b>	<b>103,334,515</b>
<b>Total Equity &amp; Reserves</b>		<b>131,389,367</b>	<b>103,349,515</b>
<b>Total Liabilities and Equity</b>		<b>561,444,643</b>	<b>492,850,312</b>

**Opinion of the Auditor - General**

The Balance Sheet of the Central bank of Sri Lanka as at 31 December 2007 and the related Income Statement, Cash Flow Statement, Statement of Movement of Equity, Summary of the significant accounting policies set out in Notes 1.1 to 1.5 and other explanatory notes set out in Notes 01 to 24 for the year then ended were audited under my direction in pursuance of provision in Article 154 of the Constitution of the Democratic Socialist Republic of Sri Lanka read in conjunction with Section 13 of the Finance Act, No. 38 of 1971 and Section 42(2) of the Monetary Law Act (Chapter 422).

I am of opinion so far as appears from my examination and to the best of my information and according to the explanations given to me, the said financial statements have been prepared and presented in accordance with International Financial Reporting Standards and give a true and fair view of the financial position of the Bank as at 31st December 2007 and the results of its operations and its cash flow for the year then ended.

19 March 2008

Auditor - General's Department  
Colombo 7.

**S. Swarnajothi**  
Auditor General

**Ajith Nivard Cabraal**  
Governor

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

**CENTRAL BANK OF SRI LANKA****Income Statement  
For The Year Ended 31 December**

		<b>2007</b>	<b>2006</b>
		<b><u>Rs. '000</u></b>	<b><u>Rs. '000</u></b>
<b>Operating Income:</b>	<b>Note</b>		
<b>Income from Foreign Currency Financial Assets</b>			
Interest Income	16	13,240,762	10,786,599
Gain /(Loss) from Unrealized Price Revaluations		4,413,887	(80,208)
Gain /(Loss) Realized from Price Changes		2,189,134	992,017
<b>Total Income from Foreign Currency Financial Assets</b>		<b>19,843,783</b>	<b>11,698,408</b>
Expenses on Foreign Currency Financial Liabilities			
Interest Expense	17	(2,226,270)	(2,258,478)
<b>Total Expenses on Foreign Currency Financial Liabilities</b>		<b>(2,226,270)</b>	<b>(2,258,478)</b>
Net Foreign Exchange Revaluation Gain /(Loss)		8,812,401	22,358,038
<b>Foreign Currency Investment Income /(Loss)</b>		<b>26,429,914</b>	<b>31,797,968</b>
<b>Income from Local Currency Financial Assets</b>			
Interest Income	16	9,516,837	5,330,970
Interest Expense	17	(551,596)	(381,426)
<b>Total Income from Local Currency Financial Assets</b>		<b>8,965,241</b>	<b>4,949,544</b>
Other Income	18	421,396	710,411
<b>Total Net Operating Income /(Loss)</b>		<b>35,816,551</b>	<b>37,457,923</b>
<b>Operating Expenses:</b>			
Personnel Expenses			
- Salaries & wages	19	(1,591,667)	(1,292,044)
- Defined Contribution plan cost	19	(187,834)	(181,476)
- Additional contribution to Post Employment Benefit Plans	19	(1,671,606)	(4,625,893)
		<b>(3,451,107)</b>	<b>(6,099,413)</b>
Depreciation & Amortization		(270,040)	(466,671)
Cost of Inventory		(1,052,160)	(1,543,026)
Administration Expenses	20	(1,172,964)	(876,632)
Bad & Doubtful Debts and Net Sundry Write Offs		(53)	-
<b>Total Operating Expenses</b>		<b>(5,946,324)</b>	<b>(8,985,742)</b>
<b>Profit /(Loss) Before Income Tax</b>		<b>29,870,227</b>	<b>28,472,181</b>
Income Tax		(1,044,842)	(620,565)
<b>Net Profit /(Loss) for the Year</b>		<b>28,825,385</b>	<b>27,851,616</b>

## CENTRAL BANK OF SRI LANKA

### Cash Flow Statement For The Year Ended 31 December

	Note	2007 Rs. '000	2006 Rs. '000
<b>Cash Flow from Operating Activities:</b>			
<b>Source:</b>			
Interest Received - Foreign Currency		13,091,488	9,777,792
Interest Received - Local Currency - Others		380,567	22,783
Liquidity Management and Trading Income		2,189,134	991,682
Realized Exchange Gain / (loss)		89,345	(352,657)
Other Income Received		348,438	474,810
		<u>16,098,972</u>	<u>10,914,410</u>
<b>Disbursements:</b>			
Interest Paid - Foreign Currency		2,234,300	2,130,611
Interest Paid - Local Currency		552,054	384,519
Payments to Employees		1,782,510	(470,892)
Payments to Suppliers		3,583,245	6,732,521
Income Tax Paid		663,653	531,545
		<u>8,815,762</u>	<u>9,308,304</u>
<b>Net Cash Flow from Operating Activities</b>	21	<u>7,283,210</u>	<u>1,606,106</u>
<b>Cash Flows from Investing Activities:</b>			
<b>Source:</b>			
Net (Increase) / Decrease in Other Local Currency Financial Assets		(822,393)	(666,266)
Principal recoveries from the Loans and Advances to Other Institutions		393,795	110,982
Disposal / Redemption of Investments in Financial and Other Institutions		(4,950)	406
Sale of Property, Plant and Equipment		-	15,025
Income on Investments in Financial and Other Institutions		28,590	9,049
Net Increase in Securities Purchased under Agreement to Re-sell		(544,000)	(13,545,000)
		<u>(948,958)</u>	<u>(14,075,804)</u>
<b>Disbursements:</b>			
Net Increase / (Decrease) in Foreign Currency Securities		6,186,179	40,459,822
Net Increase / (Decrease) in Other Foreign Currency Financial Assets		587,989	2,193,369
Net Increase / (Decrease) in Other Foreign Currency Financial Liabilities		(12,345,621)	924,448
Net Increase / (Decrease) in Other Local Deposits & Payables		4,409	192,672
Purchase of Property, Plant and Equipment net of Grants		221,448	102,230
Net Increase/(Decrease) in Gold Inventory		(181,599)	1,273,645
		<u>(5,527,195)</u>	<u>45,146,186</u>
<b>Net Cash Flow from Investing Activities</b>		<u>4,578,237</u>	<u>(59,221,990)</u>
<b>Cash Flows from Financing Activities:</b>			
<b>Source:</b>			
Issue of Circulating Currency		209,034,025	188,483,464
Withdrawal of Circulating Currency		(192,909,909)	(163,680,355)
Net Issue of Circulating Currency		16,124,116	24,803,109
<b>Less:</b>			
Net Issue / (Withdrawals) of Circulation Currency on Government Transactions	22	(21,422,909)	19,243,588
Net Issue / (Withdrawals) of Circulation Currency on Bank and Financial Institutions Transactions	23	(8,564,417)	(17,131,807)
Net Issue / (Withdrawals) of Circulating Currency		<u>(29,987,326)</u>	<u>2,111,781</u>
		46,111,442	22,691,328
<b>Disbursements:</b>			
Repayment of Foreign Currency Term Liabilities		605,092	(13,684,511)
Payments of Surplus to Government		4,015,090	-
		<u>4,620,182</u>	<u>(13,684,511)</u>
<b>Net Cash Flow from Financing Activities</b>		<u>41,491,260</u>	<u>9,006,817</u>
<b>Net Increase in Cash and Cash Equivalents</b>		<u>53,352,707</u>	<u>(48,609,067)</u>
Exchange Rate Effect on Cash and Cash Equivalents		1,097,586	8,081,942
Cash and Cash Equivalent at the Beginning of the Year		105,601,686	146,128,811
<b>Cash and Cash Equivalent at 31 December 2007</b>	24	<u>160,051,979</u>	<u>105,601,686</u>

**CENTRAL BANK OF SRI LANKA**  
**Statement of Movements in Equity as at 31 December 2007**

	Contributed Capital Rs. '000	Revaluation Reserve Rs. '000	Other Reserves Rs. '000	Accumulated Profits Rs. '000	Total Rs. '000
As at 1 January 2006	15,000	662,382	69,735,949	6,722,302	77,135,633
Net Profit	-	-	-	27,851,616	27,851,616
Transfer to RTGS Sinking Fund	-	-	40,263	(40,263)	-
Transfer Revaluation Gain	-	(7,416)	-	7,416	-
Net Effect of Adjustments and Reclassification	-	(181,909)	-	-	(181,909)
Transfer to Specific Reserve	-	-	221,903	(34,540)	187,363
Transfer of Net Foreign Exchange Revaluation Loss	-	-	22,358,038	(22,358,038)	-
Net Fair Value / (Loss) on Available for Sale Securities	-	-	(1,643,188)	-	(1,643,188)
<b>As at 1 January 2007</b>	<b>15,000</b>	<b>473,057</b>	<b>90,712,965</b>	<b>12,148,493</b>	<b>103,349,515</b>
Effect of Spot position	-	-	-	(520)	(520)
Net Profit	-	-	-	28,825,385	28,825,385
Transfer to RTGS Sinking Fund	-	-	46,341	(46,341)	-
Transfer to CBSL Specific Reserves	-	-	100,914	(100,664)	250
Transfer of Realised Revaluation Gain	-	2,233,010	-	-	2,233,010
Transfer to General Reserve	-	-	1,478,488	(1,478,488)	-
Transfer of Net Foreign Exchange Revaluation Gain	-	-	8,812,401	(8,812,401)	-
Transfer of Sales Proceed of Kandy Property	-	-	-	(15,090)	(15,090)
Transfer of Net Profit to the Government in respect of 2006	-	-	-	(4,000,000)	(4,000,000)
Net Fair Value / (Loss) on Available for Sale Securities	-	-	996,817	-	996,817
<b>As at 31 December 2007</b>	<b>15,000</b>	<b>2,706,067</b>	<b>102,147,926</b>	<b>26,520,374</b>	<b>131,389,367</b>

**CENTRAL BANK OF SRI LANKA**  
**Notes to be read as part of the Financial Statements**

	<b>2007</b> <b>Rs. '000</b>	<b>2006</b> <b>Rs. '000</b>
<b>1. Cash &amp; Cash Equivalents</b>		
Balances with Overseas Banks	6,831,527	1,182,304
Time Deposits with Overseas Banks	130,280,290	86,968,117
Time Deposits Contracted in	4,327,401	9,416,427
Deposits Under Repurchase Agreements	18,612,761	8,034,838
	<u>160,051,979</u>	<u>105,601,686</u>
<b>2. Financial Assets</b>		
Securities at Fair Value through Profit or Loss	113,583,131	107,413,474
Securities Denominated in Gold at Fair Value through Profit or Loss	13,991,886	11,905,227
Available for Sale Investments	79,541,928	68,211,989
Total Financial Assets	<u>207,116,945</u>	<u>187,530,690</u>
<b>3. IMF Related Assets</b>		
Holding in Special Drawing Rights	740,172	291,772
IMF Quota	71,023,774	66,984,442
Deposit with IMF	135,516	-
<b>Total IMF Related Assets</b>	<u>71,899,462</u>	<u>67,276,214</u>
<b>4. Advances to Government</b>		
Revolving Credit	60,679,200	49,015,400
<b>Total Advances to Government</b>	<u>60,679,200</u>	<u>49,015,400</u>
<b>5. Loans to Other Institutions</b>		
Capital Outstanding		
Related Parties	50,670	56,797
Others	2,152,116	2,141,818
Receivable under Susahana Tsunami Loan Scheme		
Related Parties	1,046,496	1,832,516
Others	1,022,861	634,807
Interest Receivable	4,218,134	4,217,107
Gross Receivable	8,490,277	8,883,045
Less: Allowance for Doubtful Receivables	(2,178,492)	(2,178,492)
Suspended Interest	(4,218,135)	(4,217,107)
Net Receivable	<u>2,093,650</u>	<u>2,487,446</u>
<b>6. Investments in Financial and Other Institutions</b>		
Credit Information Bureau Ltd	12,135	12,185
Lanka Clear (Pvt) Ltd	29,500	29,500
Fitch Ratings Lanka Ltd	3,500	3,500
SWIFT Service Bureau	5,000	-
<b>Total Investments in Financial and Other Institutions</b>	<u>50,135</u>	<u>45,185</u>
<b>7. Inventories</b>		
Notes for Circulation	1,155,948	1,757,198
Coins for Circulation	497,949	440,354
Coins in Transit	41,155	96,600
	<u>1,695,052</u>	<u>2,294,152</u>
<b>Less: Allowance for Slow Moving Items</b>	<u>(55,300)</u>	<u>(55,300)</u>
	<u>1,639,752</u>	<u>2,238,852</u>
Stationery and Sundry Inventory	25,596	28,685
<b>Total Inventories at Lower of Cost and Net Realisable Value</b>	<u>1,665,348</u>	<u>2,267,537</u>

**8. Properties, Plant and Equipment**

	Land & Buildings	Plant & Plant Integrals	Furniture & Equipment	Motor Vehicles	Computer Hardware	Others	Total 2007	Total 2006
	Rs. '000	Rs. '000	Rs. '000	Rs. '000	Rs. '000	Rs. '000	Rs. '000	Rs. '000
At 1 January net of Accumulated Depreciation	6,026,600	831,397	195,916	24,479	82,177	10,614	7,171,183	7,717,108
Revaluation	2,233,010	-	-	-	-	-	2,233,010	-
Additions	961	1,301	50,882	101,000	21,454	44,579	220,177	102,233
Disposals	-	-	-	-	-	-	-	(14,709)
Net effect of Reclassification / Written off	-	-	-	-	-	-	-	(282,560)
Depreciation charge for the year	(94,342)	(52,427)	(52,930)	(27,033)	(41,751)	(1,239)	(269,722)	(350,889)
At 31 December net of Accumulated Depreciation	8,166,229	780,271	193,868	98,446	61,880	53,954	9,354,648	7,171,183

**2007**  
**Rs. '000**

**2006**  
**Rs. '000**

**9. Intangible Assets****Computer Software**  
**Cost:**

As at 1 January	463,149	463,149
Additions	1,271	-
Disposals	-	-
<b>As at 31 December</b>	<b>464,420</b>	<b>463,149</b>

**Amortisation and Impairment:**

As at 1 January	463,149	347,362
Amortisation Charge for the year	318	115,787
<b>As at 31 December</b>	<b>463,467</b>	<b>463,149</b>

**Net Book Value:**

As at 1 January	-	115,787
As at 31 December	953	-

**10. Amounts Payable to Banks and Financial Institutions**

Payable to Foreign Banks	6,246,208	9,587,227
Payable to other Foreign Financial Institutions	484,314	547,497
<b>Total Amount Payable to Banks and Financial Institutions</b>	<b>6,730,522</b>	<b>10,134,724</b>

**11. IMF Related Liabilities**

Interest Bearing Loans – Non Current	18,809,059	26,036,677
Interest Bearing Loans – Current	8,501,764	279,102
Allocation of Special Drawing Rights	12,175,406	11,482,955
Other Amounts Payable to IMF	38,417,617	33,689,353
Quota Liability	24,387,543	25,544,136
	83,482,330	70,995,946
<b>Total IMF Related Liabilities</b>	<b>102,291,389</b>	<b>97,032,223</b>



	2007 Rs. '000	2006 Rs. '000
<b>12. Deposits by Banks and Financial Institutions</b>		
Deposits by Banks:		
- Related Parties	38,250,751	35,299,563
- Others	52,795,434	47,306,679
	<u>91,046,185</u>	<u>82,606,242</u>
Deposits by Financial Institutions		
- Related Parties	64	60
- Others	6,775	9,085
	<u>6,839</u>	<u>9,145</u>
<b>Less: Advances under Intra-day Liquidity Facility</b>	-	-
<b>Total Deposits by Banks and Other Financial Institutions</b>	<u><u>91,053,024</u></u>	<u><u>82,615,387</u></u>
<b>13. Balances with Government and Governmental Entities</b>		
Government Deposits	642,135	741,648
Government Agencies and Funds	773,940	614,703
<b>Total Balances with Government and Governmental Entities</b>	<u><u>1,416,075</u></u>	<u><u>1,356,351</u></u>
<b>14. Balances with Employee Benefit Plans</b>		
Employee Provident Fund – Related Party	713	2,137
Employee Retirement Pension Scheme – Related Party	437,867	1,558,055
Widows' /Widowers' & Orphans' Pension Schemes – Related Party	829,215	693,479
Payable in respect of Gratuity	46,487	35,235
Payable in respect of Medical Benefit Scheme	935,883	466,030
<b>Total Other Deposits</b>	<u><u>2,250,165</u></u>	<u><u>2,754,936</u></u>
<b>15. Capital &amp; Reserves</b>		
Capital	15,000	15,000
Medium & Long Term Credit Reserves	9,425,000	9,425,000
Capital Contribution Account	577,859	577,859
Fixed Assets Revaluation Account	2,706,067	473,057
Market Valuation Reserve-securities Available for Sale	(781,449)	(1,778,265)
Profit for the year	28,825,384	27,851,616
International Reserve Revaluation	61,422,435	52,610,034
Other Reserves	29,199,071	14,175,214
	<u><u>131,389,367</u></u>	<u><u>103,349,515</u></u>
<b>16. Interest Income from Financial Assets</b>		
<b>Interest Income from Foreign Currency Financial Assets</b>		
Cash & Cash Equivalents	5,956,825	4,460,836
Financial Assets	7,086,382	6,191,870
IMF Related Assets	169,872	133,893
Other foreign receivables	27,683	-
<b>Total Interest Income from Foreign Currency Financial Assets</b>	<u>13,240,762</u>	<u>10,786,599</u>
<b>Interest Income from Local Currency Financial Assets</b>		
Investment Portfolio – Sri Lanka Government Securities	9,207,485	5,173,853
Investment in Financial and Other Institutions	-	-
Other Loans and Advances	309,352	157,117
<b>Total Net Interest Income from Local Currency Financial Assets</b>	<u>9,516,837</u>	<u>5,330,970</u>
<b>Total Interest Income from Financial Assets</b>	<u><u>22,757,599</u></u>	<u><u>16,117,569</u></u>

	2007 Rs. '000	2006 Rs. '000
<b>17. Interest Expense on Financial Liabilities</b>		
<b>Interest Expense on Foreign Currency Financial Liabilities</b>		
Amount Payable to Asian Clearing Union	1,330,404	1,154,945
IMF Related Liabilities	828,182	1,064,836
Securities Sold Under Agreements to Repurchase	67,684	36,188
Other Foreign Payable	-	2,509
<b>Total Interest Expense on Foreign Currency Financial Liabilities</b>	<b>2,226,270</b>	<b>2,258,478</b>
<b>Interest Expense on Local Currency Financial Liabilities</b>		
Securities Sold Under Agreements to Repurchase	551,596	381,426
<b>Total Interest Expense on Local Currency Financial Liabilities</b>	<b>551,596</b>	<b>381,426</b>
<b>Total Interest Expense on Financial Liabilities</b>	<b>2,777,866</b>	<b>2,639,904</b>
<b>18. Other Income</b>		
Dividend Income - Related Party	12,648	3,683
- Others	394	525
Gain/(Loss) on Disposal of Property, Plant & Equipment	(12)	316
Gain/(Loss) on Disposal of Investments in Financial and other Institutions	567	344
Amortization of Deferred Grant	60,007	221,835
Miscellaneous Income	347,792	483,708
<b>Total Other Income</b>	<b>421,396</b>	<b>710,411</b>
<b>19. Personnel Expenses</b>		
Wages and salaries including PAYE paid by the employer	1,591,667	1,419,730
Post Employee Defined Benefit Plan Costs	1,671,606	3,834,000
Defined Contribution Plan Costs	187,834	181,476
Other Benefits	-	664,207
<b>Total Personnel Expenses</b>	<b>3,451,107</b>	<b>6,099,413</b>
<b>20. Administration Expenses</b>		
Repairs and Maintenance	341,234	337,176
Information	78,564	76,059
Operational Travel	20,099	16,876
Rental Expenses	1,239	1,547
Printing	23,982	17,732
Audit Fees	9,040	10,013
Remuneration to members of the Monetary Board	389	591
Interest Expense on CBSL Provident Fund	453,125	195,000
Miscellaneous	245,292	221,638
<b>Total Other Operating Expenses</b>	<b>1,172,964</b>	<b>876,632</b>
<b>21. Reconciliation of Operating Profit with Operating Cash Flow</b>		
<b>Reported Net Profit from Operating Activities</b>	<b>28,825,385</b>	<b>27,851,616</b>
<b>Add (Subtract) Non-Cash Items</b>		
Depreciation	270,040	466,672
Interest Received – Local Currency – Investment Portfolio	(9,131,665)	(5,313,769)
Bad Debt Write-Off/ (Written Back)	-	9,960
Provision for Defined Employee Benefits Plans	-	4,625,893
Gross Unrealised Foreign Exchange (Gain) Loss	(8,723,055)	(22,711,030)
Other Provision	1,943,189	1,505,358
Differed Grants	-	(218,676)
<b>Add (Subtract) Movements in Other Working Capital Items</b>		
(Increase) / Decrease in Inventories	602,189	(915,860)
(Increase) / Decrease in Interest Receivable	(141,746)	(1,010,442)
Increase / (Decrease) in Miscellaneous Liabilities	(2,304,419)	(2,812,803)
Increase / (Decrease) in Interest Payable	(36,171)	124,774
Increase / (Decrease) in Other Receivable	450,759	(66,088)

	2007 Rs. '000	2006 Rs. '000
<b>Add (Subtract) Investing and Financing Activities</b>		
Income from Investments	15,549	(4,840)
Dividend Received	(13,041)	(4,208)
Gain on Sale of Property, Plant & Equipment	-	(316)
Net Unrealised Market Value Changes	(4,413,887)	(343)
Deferred Government Grants	(59,917)	80,208
<b>Net Cash Flow From Operating Activities</b>	<b>7,283,210</b>	<b>1,606,106</b>
<b>22 Issues / (Withdrawals) of Circulation Currency on Government Transactions</b>		
Maturity of Government of Sri Lanka Securities Portfolio	(236,406,730)	(132,655,180)
Purchases of Government of Sri Lanka Securities for Investment Portfolio	212,401,293	148,788,162
Interest Received – Local Currency – Investment Portfolio	(9,021,548)	(5,733,735)
Increase /(Decrease) in Loans and Advances to GOSL	11,663,800	9,269,100
(Increase) /Decrease Balances with Government and Government Entities	(59,724)	(424,759)
Deferred Grant Received	-	-
	<b>(21,422,909)</b>	<b>19,243,588</b>
<b>23. Net Issues / (Withdrawals) of Circulation Currency on Bank and Financial Institutions Transactions</b>		
(Increase) /Decrease in Balances with Banks and Financial Institutions	(8,564,417)	(17,131,807)
(Increase) /Decrease Intra-day Liquidity Facility to Banks and Financial Institutions	-	-
	<b>(8,564,417)</b>	<b>(17,131,807)</b>
<b>24. Closing Cash &amp; Cash Equivalents</b>		
<b>Foreign Currency Assets</b>		
Cash Balances with Other Foreign Banks	160,051,979	105,601,686
Closing Cash & Cash Equivalents	<b>160,051,979</b>	<b>105,601,686</b>

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

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

The basis of accountability for the Central Bank and the success of its operations therefore would be the effectiveness of its policies and operations leading towards the achievement of its core objectives and not necessarily its profitability *per se*. These statutory objectives are the fundamental features that distinguish the Central Bank from any other entity, private or public. Accordingly, profitability related

approach, if adopted by the Central Bank, could result in the Bank pursuing profits while compromising its core objectives, since it has the unique ability to create its own profits through its monetary policy activities, which could influence interest rates and exchange rates. It therefore follows that the Central Bank's objectives of economic and price stability and financial system stability need to be distinguished and detached from the pure profitability objective which should essentially be incidental or academic only.

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

## 1.2 Reporting Entity and Statutory Base

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

These financial statements were authorised for issue by the Governor and Chief Accountant on 18th March 2008.

## 1.3 Accounting Policies

### 1.3.1 Basis of preparation

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

#### Reporting Format

The Bank presents financial assets and financial liabilities, and their associated income and expense streams, by distinguishing between foreign currency and local currency activities. In the balance sheet assets & liabilities are presented broadly in order of liquidity within such distinguished category. The Bank considers that this reporting approach provide appropriate reporting of the Bank's activities which are more fully described in Note 1.5.

#### Statement of Compliance

The financial statements of the Central Bank of Sri Lanka for the year ended 31 December 2007 have been prepared in accordance with International Financial Reporting Standard (IFRS).

#### Currency of Presentation

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

### 1.3.2. Significant Accounting Judgments and Estimates

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

#### Impairment of Available for Sale Investments

The Bank determines that Available for Sale Investments are impaired when there has been a

significant or prolonged decline in the fair value below its cost. This determination of what is significant or prolonged requires judgment.

#### Pensions and Other Post Employment Benefit Plans

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

### 1.3.3 Adoption of Amended IFRS during the year

The accounting policies adopted are consistent with those used in the previous year. The Bank adopted IFRS 7: Financial Instruments- Disclosures & complementary amendments to IAS1, Presentation of Financial Statements Capital Disclosures.

The Principal effects of these changes are as follows:

#### IFRS - 7 Financial Instruments: Disclosures

This standard requires disclosures that enable users of the financial statements to evaluate the significant of the Bank's financial instruments and the nature and extend of risks arising from those financial instruments. The new disclosures are included through out the financial statements. While there has been no effect on the financial position or results, comparative information has been revised where needed.

#### IAS-1 Presentation of financial statements

This amendment requires the group to make new disclosures to enable uses of the financial statements to evaluate the group's objectives, policies and processes for managing capital.

### 1.3.4 Standards, interpretations and amendments to published standards that are not yet effective

Certain new standards, amendments and interpretations to existing standards have been published that are applicable for the Bank's accounting periods beginning on or after 1 January 2008 or later periods but which the Bank has not early adopted, as follows:

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

## 1.4 Summary of Significant Accounting Policies

### 1.4.1 Foreign Currency Conversions

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

	2007 Rs.	2006 Rs.
1 Australian Dollar	<b>95.5807</b>	85.2221
1 Canadian Dollar	<b>111.0061</b>	92.8256
1 Euro	<b>160.2741</b>	141.5844
1 Japanese Yen	<b>0.9713</b>	0.9050
1 Special Drawing Rights (SDR)	<b>171.8040</b>	162.0330
1 Sterling Pound	<b>217.1507</b>	211.2861
1 United States Dollar	<b>108.7194</b>	107.7056

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

### 1.4.2 Financial Assets and Liabilities

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

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

All financial assets are initially recognised at cost, being the fair value of the consideration given and including acquisition charges associated with the investment. Subsequent measurement bases after initial recognition are described below. All regular way purchases and sales of financial assets are recognised on the trade date respectively. Regular way purchases or sales are purchases or sales of

financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place.

#### Securities at Fair Value through Profit or Loss

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

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

#### Foreign Currency Available-for-Sale Investments

Foreign currency available for sale investments are subsequently valued at quoted market prices. Changes in market value are recognised as an increase or decrease in the value of the available for sale securities in the Balance Sheet under reserves.

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

#### Securities denominated in Gold

Gold securities held with foreign counter parties are initially stated at cost. Gains and losses arising from changes in the market value of Gold Securities are recognised in the Income Statement. Where the Gold Securities are still owned, the gain or loss is reported as Gain /(Loss) from Unrealised Price Revaluations. Where the gain or loss has been realised (through selling the Gold Securities), this is reported as Gain /(Loss) Realised from Price Changes.

#### Derivative Instruments

The Bank's involvement in derivative instruments is mainly in forward foreign exchange contracts. Such derivative financial instruments are stated at fair value. The fair value of forward exchange contracts is calculated by reference to current forward exchange rates for contracts with similar maturity profiles. All derivative instruments in a gain



or loss position, if any, are reported within the balance of foreign currency trading or available for sale securities in the Balance Sheet.

### **International Monetary Fund (IMF) Related Balances**

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

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

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

### **Cash and Cash Equivalents**

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

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

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

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

obtained, which is either added to the currency in circulation liability or Deposits by Banks and Financial Institutions. Such forms of utilization of currency for the purposes of CBSL's payments form part of cash outflows of CBSL.

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

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

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

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

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

The Bank's investment portfolio consists of treasury bills and bonds purchased from Government of Sri Lanka. The portfolio is recorded in the Balance Sheet at amortised cost since they represent loans provided to the GOSL.

### **Advances to Government**

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

### **Loans to Other Institutions**

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

### **Securities Lending**

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

### **Impairment of Financial Assets**

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

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

If there is objective evidence that an impairment loss on loans and receivables carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition). The carrying amount of the asset shall be reduced either directly or through use of an allowance account. The amount of the loss shall be recognised in the Income Statement.

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

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

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

If an available-for-sale asset is impaired, an amount comprising the difference between its cost (net of any principal payment and amortisation) and its

current fair value, less any impairment loss previously recognized in profit or loss, is transferred from equity to the income statement. Reversals in respect of equity instruments classified as available-for-sale are not recognised in profit. Reversals of impairment losses on debt instruments are reversed through profit or loss, if the increase in fair value of the instrument can be objectively related to an event occurring after the impairment loss was recognised in profit or loss.

### **Foreign Currency Term Liabilities**

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

### **Financial Guarantees**

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

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

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

## **1.4.3 Other Assets and Liabilities**

### **Investments in Associates**

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

### **Gold Inventory**

Gold inventory, which is a highly liquid commodity, is carried at cost.

### **Inventories**

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

### Property, Plant and Equipment

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

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

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

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

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

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

the year the asset is de-recognised. The asset's residual values, useful live and methods are reviewed, and adjusted if appropriate, regularly.

### Intangible Assets

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

### Receivables

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

### Sundry Assets

Sundry assets are carried at expected realisable values.

### Impairment of Non-Financial Assets

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

### Provisions

Provisions are recognised when the Bank has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where the Bank expects a provision to be reimbursed, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain.

### Currency in Circulation

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

### Pension and Other Post Employee Benefit Plans

#### Defined Benefit Plans

The Bank operates defined benefit schemes for Pension, Widows' and Orphans' Pensions (W&OP), Widowers' and Orphans' Pensions (WR&OP),



Retirement Gratuity and Post Employment Medical Benefits Contributions are made by the Bank and eligible beneficiaries make contributions, to separately administered funds in respect of the first three schemes. The cost of providing benefits under the defined benefit plans is determined separately for each plan using the projected unit credit actuarial valuation method. Actuarial valuations are carried out once in every three years

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

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

#### **Defined Contribution Plans**

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

#### **Grants**

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

#### **Personnel Expenses**

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

#### **Operating Leases**

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

#### **Income Tax**

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

#### **Revenue & Expenses**

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

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

#### **Interest**

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

#### **Dividends**

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

#### **Miscellaneous**

Miscellaneous income and expenses are recognised on an accrual basis.

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

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

Contingent Liabilities and Commitments including Off Balance Sheet Items

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

### 1.5 Nature and Extent of Activities

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

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

The activities carried out in order to achieve its objective of economic, price and financial system stability with a view to encouraging and promoting

the development of the productive resources of Sri Lanka, can be broadly segregated into foreign currency and local currency activities. Results of these activities are taken to mean Operating Activities in the context of the Income Statement

#### Foreign Currency Activities

Foreign currency activities result mainly from the Central Bank of Sri Lanka's holdings of foreign currency assets under its foreign reserves management function. The foreign reserves management portfolio comprises foreign currency assets held for foreign exchange intervention purposes and other foreign currency assets held for trading purposes.

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

The Central Bank of Sri Lanka also holds, from time-to-time, foreign currency assets and liabilities that arise from international market operations.

#### Local Currency Activities

Local currency activities arise as follows:

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

#### Trust and Custodial Activities

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

## 2. BANK SUPERVISION

The regulatory and supervisory function of the Central Bank relating to banks licensed by the Monetary Board of the Central Bank of Sri Lanka (CBSL) is carried out by the Bank Supervision Department (BSD), with a view to ensuring the safety and soundness of the banking system, and promoting financial system stability. As at end 2007, 38 licensed banks, i.e., 23 licensed commercial banks (LCBs) and 15 licensed specialized banks (LSBs), were in operation under the regulation and supervision of the Central Bank.

These banks, in alphabetical order, are at Annex I.

The activities of the BSD include enforcing regulatory and supervisory requirements, adopting new regulatory and supervisory measures, granting regulatory approvals and implementing risk based supervision through continuous monitoring and examination of banks. A summary of the activities undertaken in 2007 is given below.

### 2.1 Prudential Regulation

The BSD issued several new prudential regulations and guidelines, as well as amendments to existing prudential requirements, to the licensed banks in 2007. Details are contained in Part III of this report and a summary is as follows.

- a. Limits on share ownership in banks: A new share ownership scheme with regard to shares carrying voting rights was introduced with the objective of promoting better corporate governance and to address any conflicts of interest that may arise due to large shareholdings. Accordingly, the maximum percentage of ownership permitted in the issued share capital carrying voting rights will be 15 per cent of issued share capital. However, to acquire shares in excess of 10 per cent, the approval of the Monetary Board (MB) and the concurrence of the Hon. Minister of Finance will be required. The MB may grant permission to acquire more than 15 per cent of the share capital of a bank which requires restructuring to avoid inadequacy of capital, insolvency or potential failure, subject to conditions.
- b. Maximum amount of accommodation: Criteria adopted in determining the maximum amount of accommodation were revised with the view to mitigating banks' credit concentration risk. The maximum amount of accommodation to a single counter-party and for a group of companies will be 30 per cent and 33 per cent, respectively, of the capital base of the bank. Enhanced limits of 36 per cent-40 per cent of the capital base in

respect of a group will be applicable depending on the status of risk management of banks and companies in terms of the capital adequacy ratio of the bank and the external credit ratings of the borrower and the bank.

- c. Inclusion of new capital instruments in regulatory capital: Banks were permitted to include perpetual debt capital instruments that satisfy certain conditions, as core capital, thus broad-basing the capital instruments that are considered in the computation of the capital adequacy ratio. The eligibility criteria of hybrid (debt/equity) capital and subordinated debt instruments were also expanded.
- d. Issue of directions on corporate governance: Directions on corporate governance, which have been developed on the basis of certain principles of corporate governance, were issued to licensed banks, to be applicable from 1 January 2008. The main aspects covered are: the broad responsibilities of the board of directors, the board's composition, criteria to assess the fitness and propriety of directors, management functions delegated by the board, separation of duties of the Chairman and Chief Executive Officer, board appointed committees and disclosure of financial statements. A number of transitional provisions on several key aspects of these rules have been provided to facilitate a smooth transition to these new directions. These directions are aimed at making boards of directors more responsible and accountable for the business operations of banks to promote a healthy and robust risk management framework for banks, in order to maintain the overall soundness of banks.
- e. Adoption of Basel II: Directions were issued to all licensed banks on the adoption of Basel II, effective from 1 January 2008. Accordingly, banks are required to apply the Standardised Approach for credit risk, the Standardised Measurement Method for market risk and the Basic Indicator Approach for operational risk, in computing the capital requirement. This new framework is intended to improve the safety and soundness of the banking system by aligning capital adequacy assessment more closely with the underlying main risks in banks. It is also intended to provide banking institutions with stronger incentives to improve risk measurement and allow complementary use of market mechanisms to have a greater accountability to other stakeholders of banks.

- f. Customer due diligence – ‘Know Your Customer’ Procedures: All banks were requested to conduct due diligence in respect of customers involved in cross-border financial transactions and to notify the relevant authorities of any suspicious transactions as required by relevant statutes.
- g. Guidelines on the employment of expatriate staff in banks : Guidelines were issued on procuring services of expatriates in the banking sector. This policy change was required due to the significant expansion of banking operations of foreign banks, the need for the introduction of innovative financial products and the need for expertise in the areas of advanced risk management practices and rapid developments in information technology infrastructure.

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

During 2007, the BSD continued to process requests for banking licences and for the opening, closing and relocation of bank branches and other banking outlets, in terms of the Banking Act. Permission was granted to merge Lankaputhra Bank Ltd. and SME Bank Ltd. During the year approvals were granted for 72 new branches, 151 banking outlets (such as extension offices, mobile banking units and student savings units), relocation of 37 branches and 02 extension offices and upgrading of 14 banking outlets and installing 14 off-site Automated Teller Machines (ATMs). Accordingly, there were 1,616 branches, 2,137 other banking outlets and 1,141 ATMs in operation at the end of 2007. Further, approval was granted for broad-basing access to banking and financial services. Technology driven services, such as mobile commerce banking, were approved to be introduced to the market, based on advancements in information and communications technology.

## 2.3 Continuous Monitoring of Licensed Banks

Continuous supervision is a process where the banks’ performances are monitored by analysing the periodical information forwarded by banks through the on-line web based reporting system. The continuous monitoring serves as an early warning system in identifying significant and critical changes in the financial conditions of banks, which require further investigation and examination. In addition, special assignments such as assessment of credit card operations, analysis of ownership structures of relevant banks, assessment of provisioning of non-performing loans, preparation of a database of abandoned property and an impact assessment of the Basel II capital adequacy framework were undertaken during the year under review.

## 2.4 Statutory Examinations of Licensed Banks

In terms of the provisions of the Monetary Law Act and the Banking Act, all LCBs and LSBs are subject to statutory examinations, at least once in two years. The BSD continued to adopt a risk-based examination process which focuses on identification of banking risks, the management of these risks and the assessment of the adequacy of resources to mitigate risks. A more risk focused examination procedure was introduced during the year. This new procedure places a greater emphasis on:

- (a) identifying the risk profiles and strengths and weaknesses in risk management,
- (b) evaluating the adequacy of systems and controls, and
- (c) evaluating the financial performance of banks and banking groups.

The overall aim of this process is to identify and deal with emerging vulnerabilities in the banking sector, which could undermine the overall financial system stability.

In 2007, the BSD engaged in 28 statutory examinations, which included 13 examinations that commenced in 2007 and the completion of 15 examinations that commenced in 2006. The examinations of 21 banks were completed through formal meetings with the management of respective banks and submission of reports to the Monetary Board in 2007 and 7 examinations awaited completion. Concerns on corporate governance, inadequate systems and controls, exposure to related party transactions, under-estimation of non-performing loans and provision for bad and doubtful loans, weak administration of loan accounts and potential credit risk and lapses in submission of periodical returns to the regulatory authorities were some of the supervisory concerns observed during the examinations.

## 2.5 Investigations into the Conduct of Prohibited Schemes

BSD continued investigations into the conduct of schemes prohibited under Section 83 (c) of the Banking Act. BSD attended to proceedings with regard to 3 legal cases against parties suspected as promoters of such schemes and facilitated the Criminal Investigations Department of the Police by providing technical support for the conduct of investigations. The BSD also continued its public awareness programmes to educate the public on the dangers of becoming involved in illegal and fraudulent pyramid and multi-level type marketing



schemes, and sought the cooperation of the public to inform the department of any such prohibited schemes operating in different parts of the country.

## 2.6 Resolution Action on the Failed Pramuka Savings and Development Bank Ltd.

The department provided necessary guidance and assistance during the year to set up Sri Lanka Savings Bank Ltd (SLSBL) to take over the business of the failed Pramuka Savings and Development Bank Ltd. (PSDB), the management affairs of which had been vested with the Director of Bank Supervision following the suspension of its business in October 2002. In terms of the provision of Section 76M(3) of the Banking Act, No. 30 of 1988 as amended, the Monetary Board vested the business of PSDB in SLSBL with effect from 1 August 2007. The scheme for meeting the claims of creditors and depositors on liabilities of PSDB, which was prepared with the consent of the SLSBL and approved by the Monetary Board on 5 November 2007, was published in newspapers on 3 December 2007. The newly formed bank has been requested to commence operations in 2008.

## 2.7 Administration of the Voluntary Deposit Insurance Scheme

The BSD continued to administer the voluntary Deposit Insurance Scheme, which commenced operations in 1987. This scheme is open to banking institutions licensed by the Central Bank and co-operative societies registered under the Co-operative Societies Law No.5 of 1972, which accept deposits. In 2007, only one Multi-Purpose Co-operative Society has insured itself under the scheme in respect of deposit liabilities of its rural banks. The deposit insurance fund, consisting of the premium collected and Rs.50 million allocated by the Central Bank in 1997, stood at Rs.223 million as at 31 December 2007. These funds have been invested in government securities.

## 2.8 Common Banking Forum

BSD continued to facilitate several institutional arrangements that have been established to provide fora to debate and discuss current issues in the financial sector. These arrangements consisted of the following:

- (a) Monthly meetings with Chief Executive Officers (CEOs) of Banks: These meetings serve as a forum to exchange views on issues and policies relating to banking operations. With a view to obtaining a feedback from the banks, all major policy and operational matters are discussed at

these meetings prior to their implementation. Some of the major policy and operational issues discussed were the implementation of regulations on the maximum amount of accommodation, implementation of Basel II, adoption of regulations on corporate governance, introduction of new capital instruments and the classification of loans as non-performing and matters relating to the adoption of International Accounting Standards. In addition to regular updates on recent economic and monetary developments in the country, an update on recent banking sector developments was also introduced to these meetings in 2007. Furthermore, the CEOs were apprised of the developments in international financial markets.

- (b) Inter Regulatory Institutions Council: The Inter-Regulatory Institutions Council (IRIC), which is a high level committee appointed in January 2007, is chaired by the Governor of the Central Bank of Sri Lanka. It comprises the heads of the National Payment Council, Sri Lanka Accounting & Auditing Standards Monitoring Board, Securities and Exchange Commission of Sri Lanka, Insurance Board of Sri Lanka, Colombo Stock Exchange, Department of Registrar of Companies, The Institute of Chartered Accountants of Sri Lanka, Department of Co-operative Development. IRIC was set up to ensure that appropriate policy directions are set out for orderly development of financial markets and that all regulatory agencies coordinate and exchange information in the interest of the wider financial system stability.

BSD provided secretarial assistance to the Committee. IRIC had 6 meetings in 2007 and its activities focused mainly on sharing information among regulators, enhancing corporate governance in financial institutions, adoption of IAS 32, 39 and IFRS 7 by banks, supervision of microfinance institutions, development of the capital market, persuading companies to obtain listings on the Colombo Stock Exchange to enhance transparency and accountability, and introducing a Securitisation Act.

- (c) Working Group of Regulators on Financial Conglomerates: This committee, which was appointed in 2005, held three meetings during the year and discussed matter relating to information sharing, business contingency planning, and the implementation of Basel II, among other matters. The terms of reference

(TOR) of the committee was amended with the setting up of the Inter Regulatory Institutions Council (IRIC). Accordingly, the objectives of the group are to assess the systemic risks of financial conglomerates, to recommend a course of action for the regulation and supervision of the respective institutions on a consolidated basis and to propose necessary legal reforms to address existing limitations, if any, in the legal framework relating to the regulation and supervision of financial conglomerates. A survey was undertaken to find out information requirements to and barriers to inform information action shairing among regulations.

## 2.9 Preparations for the Implementation of Basel II

With a view to moving to the Basel II Capital Adequacy Framework in 2008, several steps were taken during 2007. A consultative paper was released to banks providing guidelines on the major areas of the framework in June 2007. These new guidelines replaced the guidelines issued in 2006 on the parallel computation of capital adequacy. The impact of the Basel II on the banks' capital was monitored based on the results from the parallel computation of capital adequacy under the new guidelines since June 2007. Incorporating the feedback received from the stakeholders on the consultative paper, the Directions on Basel II was issued in December 2007.

A committee appointed in 2005 consisting of officials from the CBSL, banks and auditors continued their work relating to the development of policies for definitions and IT related issues. Also, the BSD continued its capacity building activities to prepare the banking institutions for a smooth transition to the new regulatory framework. Accordingly, several local training programmes and an international seminar was held for bank officers during the year.

## 2.10 Public Awareness Programme

As a part of the overall public awareness programme of the CBSL, the BSD continued to disseminate information to the public with a view to educating the public on the financial system and on the need to be cautious of risk and return in their transactions with financial institutions. Particular emphasis was placed on the dangers in investing in prohibited schemes.

Advertisement in Sinhala, Tamil and English were published regularly to educate the public of fraudulent methods of pyramid schemes and risks involved in participation in such prohibited schemes. Accordingly, in 2007, the BSD published three advertisements in the press titled "Say "No" to Easy

*Money, Protect Hard – Earned Money from Pyrmid Proposal*", "Have You Deposited Your Money in Institutions Legally Permitted to Accept Deposits?" and "Have You Invested your Money in Legitimate Instruments or Institutions? Have You Evaluated the Return against the Risks involved in Your Investments?" in all three languages in national newspapers. A brochure containing information on the dangers of investing in prohibited schemes was designed and circulated by the BSD through commercial banks to their customers. Furthermore, arrangements were made with the Secretary to the Ministry of Public Administration to issue an internal circular to all Divisional Secretaries to educate Grama Sevaka officers on these prohibited schemes and to dispatch the brochures prepared by the BSD to Grama Sevaka officers in all parts of the country, who could, in turn, educate the general public.

### Annex I Licensed Commercial Banks

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

### Licensed Specialized Banks

1	Ceylinco Savings Bank Ltd.
2	DFCC Bank
3	Housing Development Finance Corporation Bank of Sri Lanka
4	Kandurata Development Bank
5	Lankaputhra Development Bank Ltd.
6	National Savings Bank
7	Rajarata Development Bank
8	Ruhuna Development Bank
9	Sabaragamuwa Development Bank
10	Sanasa Development Bank Ltd.
11	S M E Bank Ltd.
12	State Mortgage and Investment Bank
13	Sri Lanka Saving Bank Ltd.
14	Uva Development Bank
15	Wayamba Development Bank

### 3. CENTRE FOR BANKING STUDIES

During the year, the Centre for Banking Studies (CBS) carried out its activities by conducting a wide range of training programmes, educational forums and public seminars, as in the previous year. In addition, special attention was paid to achieve its mission, i.e., to become a Centre of Excellence in Training in the Financial Sector in the Region.

The training programmes conducted were in the areas of Banking & Finance, Accounting & Financial Management, Legislation Relating to Financial Institutions, Information Technology, Languages and Communication Skills, Management, Rural Sector Development and Microfinance Programmes. Special programmes requested by some financial institutions were also conducted in line with its mission. Deviating from the past year regular activities, the CBS's role was expanded to cater the Region by conducting timely important international training programmes with the assistance of world best resource persons.

The CBS also conducted a series of public seminars and commemoration lectures on important current issues with the participation of eminent local and foreign guest speakers. These seminars and lectures were designed to disseminate novel ideas and to provide a forum for professionals and academics to express their views. Under the educational programmes, in 2007, CBS conducted a lecture series on television for the benefit of GCE (A/L) students. During the year 2007, a separate division was established at the CBS to handle the activities relating

to microfinance, and conducted its scheduled programmes in Colombo and outstations. Taking into account the requests and considering the importance of capacity building of the officials, CBS conducted several Certificate Courses for the Central Bank staff and certain specific professionals such as journalists.

Altogether, the CBS conducted 145 programmes during 2007 comprising 57 scheduled local programmes, 02 international programmes, 30 special seminars/courses offered on demand, 14 public lectures, 16 educational seminars and 26 microfinance programmes. The number of participants who attended these programmes was 1493, 139, 911, 2160, 1361 and 593 respectively giving a total of 6,657.

Among the training courses/programmes offered during the year, were the following: Exchange Control Regulations for Financial Institutions, Law Relating to Lending and Financial Transactions, Legal Aspects relating to Collateral, Lending on Pledge of Jewellery, Debt Securities Market in Sri Lanka, Hire Purchase and Lease Financing, Disaster Recovery and Business Continuity Planning (BCP) in Financial Institutions, Econometrics & E-Views, Currency Notes and Counterfeit Aspects, International Course on BASAL II, International Course on Central Banking and Preparation of Credit Appraisals had a higher demand.

Under the Rural Finance Sector Development Programme (RFSDP), which was funded by ADB and the Government of Sri Lanka, 05 Training of Trainer (TOT) programmes and 21 retail programmes were conducted. Of these, 04 programmes were conducted in the Central and Uva Provinces. The programmes were offered in three languages of Sinhala, Tamil and English.

Further, CBS maintained a good rapport with stakeholder institutions by organizing its training programmes/courses. One of the attempts made by CBS during 2007 was to conduct more market friendly programmes with high quality. In this respect, attention was paid to obtain the services of eminent international resource persons.

### 4. COMMUNICATIONS

With an objective of improving external and internal communication to create constant awareness and confidence so that the Bank could achieve its core objectives of price and financial system stability effectively, the Communications Department continued to discharge its services fulfilling external and internal communication requirements.

For the purpose of external communications, the Department continued to release daily Exchange Rates, weekly and monthly Economic Indicators, Consumer Price Indices and information on Government Securities such as Treasury Bills and Treasury Bonds. During the year 1188 press releases and notices, 11 gazette notifications and 212 newspaper advertisements were released. Giving an opportunity for the media persons to interact with the Bank, the Department organized 18 press conferences on various economic issues and developments. In addition to these, the Department initiated several new communication apparatus during the year to enhance its communication services. Among them, the newly designed Central Bank website was the most notable one. The new website was successfully launched in March 2007 and it helped improve coverage, timeliness and accessibility of information through easy navigation. The site comprises of comprehensive set of information relating to all key functions of the Bank and the latest economic and financial sector information generated within the Bank. The dramatic increase in the number of hits from 600 per day in 2006 to 88,000 per day in 2007 itself is a clear indication of its success over the past years. The site has been kept always updated throughout the year.

To improve the efficiency in internal communication, the Department introduced a dynamic internal web-portal named CBSLdaily during the year. This web-portal provides most of the necessary information that the employees require knowing while they are engaged in day to day work. The site contains a large collection of information ranging from weather reports to local and foreign news related to banking and finance, important economic indicators, social activities, announcements and notices to employees. It also facilitates an on-line forum for the employees to take part in constructive discussion on current topics. Indicating the popularity of the site among the staff, it received about 300 hits per day on an average during the year. 'Kauluwa', the internal news and features magazine is the other main tool of communication used for internal communication. A new face look was given to it in 2007, making it more attractive and spacious. This new structure enabled accommodating more news and features per issue.

Under the educational and public awareness activities 25 public awareness programmes and school seminars on topics related to economics, banking and finance were organised during the year 2007. An educational video drama was also produced for the general public to understand the concept of inflation through their day to day experiences.

The Department participated in various exhibitions and other public events both to distribute its publications and to create awareness about the Bank among the public. As in the previous years the participation in the Colombo International Book Fair was a commendable success. The Department could sell most of its publications through the sales outlet operated in this fair. Participation in other exhibitions like 'Deyata Kirula' National Exhibition was also notable.

The Bank continued to publish its own publications during the year 2007. The main Departmental publications were, 'Satahana' issued once in two months and its Tamil version 'Kurippeddu', the 'News Survey' the quarterly magazine and 'Kauluwa', issued monthly. Due to the expansion of distribution network, sales of Satahana have been increased from 4,000 to 12,000 copies during the year.

The Central Bank Press, continued to meet almost all the printing requirements in the Bank. The regular printing assignments included the printing of Sri Lanka Socio Economic Data, Economic and Social Statistics of Sri Lanka, News Survey, Satahana, Kauluwa, Staff Studies and Financial System Stability. In addition, the Strategic Plan 2007, and Public Debt Management in Sri Lanka were printed as special publications. Along with these printing assignments, the Press completed 315 printing assignments including the Greeting Cards and the CBSL Diary. The Press also provided the cover and page design of the 2006 Annual Report, and cover designs for several other publications.

The photographic unit of the Department was one of the busiest units during the year, handling all the photographic coverage requirements in the Bank single handedly.

With the aim of conveying the Central Bank's degree of integrity and professionalism and its objectivity through a carefully designed outlook, the department initiated the necessary steps to introduce a new corporate design for the Central Bank of Sri Lanka aiming to commence from 1<sup>st</sup> January 2008. This new corporate design would reflect the values by which the Bank is guided and to which it would adhere to.

### **Library and Information Centre (LIC)**

The Library and Information Centre (LIC) continued to provide library services for the Bank staff and others on request. It increased its collection of books from 19,792 to 20,585, reports from 13,335 to 13,826, CDs from 1,020 to 1,081 and added 280 bound volumes to the collection during the year. The Library at the Centre for Banking Studies too increased its collection of books from 5,144 to 5,272.



The usage of the 'Science Direct' database, which gives on-line access to over 100 journals on Economics, Econometrics and Finance was increased. Consequently, LIC reduced the subscription of journals from 172 to 120.

During the year under review, LIC continued to compile electronic publications such as Recent Additions (i.e., new books), List of selected Articles, News on Central Banking, News Alert and disseminated them via intranet. A Selective Dissemination of Information (SDI) Service was commenced for Heads of Departments by preparing a user profile and matching it with the databases.

In order to encourage bank staff to use on-line library facilities, 10 user education programmes covering 10 departments were introduced. In order to educate the users of these facilities 03 presentations for CBSL staff were held. Economics and Banking Library Network of Sri Lanka (EbanklibnetSL) was re-activated and its 22 member libraries were benefited immensely by sharing information via e-mail. LIC organized a book exhibition during the National Reading Month in October, exhibiting about 450 new titles purchased. A good response was shown by the staff for this exhibition. Book Review Competition, Selection of Best Reader and Quiz Programme by e-mail were other popular items of the National Reading Month Programmes. A lecture on "What is a book review?" was organised by the LIC to encourage the Bank Staff to write Book Reviews.

Self Access Language Laboratory was shifted to the Library and Information Centre from the Centre for Banking Studies, Rajagiriya to make easy access to this facility by CBSL Staff. Three Units of Compact shelves were installed in the Reference Section of the Library for shelving and preservation of unbound technical periodicals and reports with technical instructions from Central Engineering Consultancy Bureau and supervision of the Premises Department of the CBSL. LIC organized a documentary film show to encourage usage of the Library.

## 5. CURRENCY

### 5.1 Currency issue and management:

The Central Bank of Sri Lanka, being the sole authority of issuing legal tender in Sri Lanka, continued issuing currency notes and coins during the year 2007 to facilitate payments and settlements in domestic currency. The value of new and serviceable currency notes issued to commercial banks by the Currency Department (CRD) during the years was Rs.37 and Rs.172 billion, respectively. CRD also accepted deposits of currency notes from

commercial banks with value of Rs. 193 billion. Accordingly, the net issue of notes was Rs. 16 billion. The value of currency notes and coins in circulation by the end of 2007 stood at Rs.173 billion representing an annual increase of 10 per cent over 2006. Notes comprised 97 per cent of the total currency in circulation, while the balance of 3 per cent was in coins.

### 5.2 Cost effective measures for issuing and managing currency:

During the year, the CRD has adopted the following measures to reduce the issuing cost of currency.

- (a) Mobilizing idle coins into circulation. Cost of minting coins has been escalating significantly in recent times mainly due to rising international metal and energy prices. To address this situation the Currency Department (CRD) started an island-wide program to bring coins lying idle in households and religious places into circulation so that a significant part of the annual cost of minting coins in UK Pounds could be saved. CRD was able to collect idle coins worth Rs. 28.6 mn. from eight districts during the year.

The coin collection program was conducted through school network using school children to mobilize idle coins accumulated in households for re-circulation. Commercial banks, other banks and non-bank public institutions were involved in these programmes. The school network was selected, as it could deliver multiple benefits, such as improving awareness on currency, counterfeiting and clean note policy among the school children, inculcating saving and banking habits among them, supporting them to improve their extra curricular activities and using children as the vehicle for transmitting the knowledge on currency to the rest of the society.

- (b) Melting slow moving and low value scrap coins. There was a significant amount of slow moving aluminum coins in the denominations of Cts. 10 and 5 in CRD vaults occupying a large floor space. CRD melted a stock of these coins with the support of the Industrial Development Board (IDB) which purchased aluminum ingots to be issued to prospective buyers. The CRD collected around Rs. 3.0 mn. from those sales.

#### Detection of Counterfeit Notes

Maintaining public confidence in currency is one of the main responsibilities of the Central Bank. Accordingly, the CRD further improved security features of currency notes during the year under review to make it more difficult to counterfeit. It

also continued to work in close cooperation with the Counterfeit Currency Bureau of the Criminal Investigation Department to contain and minimise counterfeiting attempts. Accordingly, CRD attended 26 court cases on counterfeiting. In addition, CRD increased the number and coverage of awareness programs to broad base and improve public awareness on the security features of genuine currency notes. These measures helped curtail the number of counterfeit notes detected in the country and referred for certification to the Central Bank to 1.9 notes per million notes in circulation in 2007. The corresponding figure in 2006 was 2.23 notes.

#### **Clean note policy and processing of currency notes**

Maintaining the quality of the notes in circulation is another responsibility of the Bank under its clean note policy. Accordingly, the CRD continued to remove unserviceable notes from circulation. Two currency verification, counting, and sorting (CVCS) machines in the CRD processed 98.7 million serviceable currency notes and destroyed 21.1 million unserviceable notes during the year.

The CRD installed a disintegrator in March 2007 to destroy unserviceable currency notes received from commercial banks. This machine has a shredding capacity of 900,000 unserviceable currency notes per day. Accordingly, a stock of 174 Mn. unserviceable notes accumulated since 2005 were destroyed with this machine during its installation day of 21.03. 2007 to 31.12.2007.

#### **Sale of Commemorative Notes and Coins**

The Department continued to sell commemorative notes and coins to numismatists, collectors and the general public. The Central Bank website provides updated information about these coins. The department also made pre-arrangements to issue two commemorative coins to mark Sri Lanka being the runner up at 2007 Cricket World Cup. These two coins will be issued in mid 2008.

CRD prepared three different types of coin packs with three different series with 1) portrait of King George VI, 2) the Armorial Ensign of Ceylon, and 3) the Armorial Ensign of Sri Lanka (new coinage) to meet the public demand for such items. Two TV and radio programmes were also conducted to publicise the availability of these coin packs and their important features.

#### **Training and Awareness Programmes**

The Currency Department conducted awareness programmes on bank notes with special reference to the identification of counterfeit notes, clean note policy and recirculation of coins for bank officers, police officers, school children, government employees and the general public through public lectures, seminars and electronic and print media. The number of such programmes conducted during 2007 was 34.

CRD also conducted a special series of awareness programmes to the officers of District Courts in response to a request of the Secretary to the Ministry of Justice and Law Reforms. Under this programme CRD covered 10 district courts. Other districts will be covered in 2008.

Officers of the CRD also had the opportunity of attending a one day training programme on counterfeit detection conducted under the auspices of De La Rue Currency UK for Central Bank in September 2007.

The department also participated in the following exhibitions with a view to enhancing public awareness on currency handling.

1. Deyata kirula Exhibition held at the BMICH from 2<sup>nd</sup> to 7<sup>th</sup> February 2007.
2. Educational exhibition at Rathnavali Balika Vidyalya – Gampaha from 28<sup>th</sup> February to 4<sup>th</sup> March 2007.
3. Anurapura Udanaya exhibition held at Anuradhapura from 22<sup>nd</sup> to 25<sup>th</sup> March 2007.
4. Educational exhibition held at Holy Family Convent – Kegalle from 3<sup>rd</sup> to 7<sup>th</sup> April 2007.
5. Educational exhibition held at Rajapaksa Maha Vidyalaya - Weeraketiya from 7<sup>th</sup> to 12<sup>th</sup> May 2007.

The Central Bank stall at all these exhibitions was well patronised by school children and members of the public.

### **6. DOMESTIC OPERATIONS**

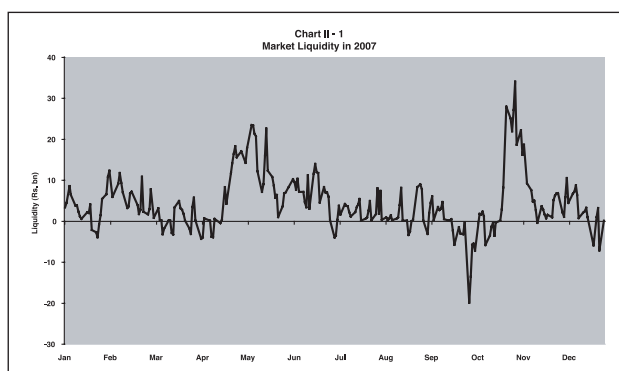
The Domestic Operations Department (DOD) continued to perform its major functions of implementing the monetary policy of the Central Bank and serving as the banker to the government and commercial banks. In addition, the department continued to provide Intra Day Liquidity to

commercial banks and primary dealers so as to ensure fund availability for settlements which are to be made and are under the Real Time Gross Settlement System (RTGS).

## 6.1 Implementation of Monetary Policy

### (a) Open Market Operations (OMO)

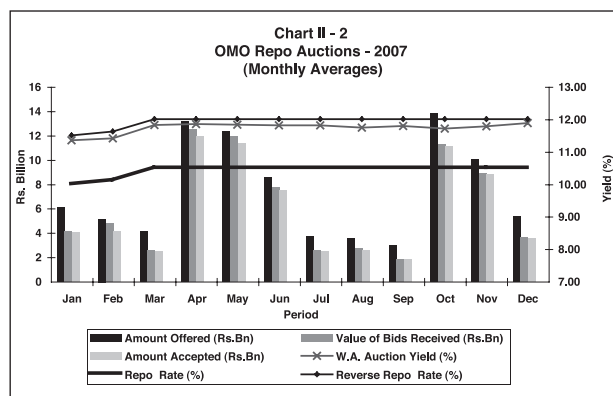
The department continued to conduct OMO within the framework of market based monetary policy operations introduced in 2003. During the year, OMO were conducted aggressively to absorb liquidity as a strategy for maintaining reserve money within the targets. Accordingly, while conducting auctions for repurchase (REPO) transactions to absorb liquidity on a daily basis, Treasury bills out of the holdings of the Central Bank were sold in the secondary market through auctions to absorb liquidity on a permanent basis. REPO transactions under the standing facility too were continued. In line with this strategy, auctions were not conducted to release funds through reverse repurchase (Reverse REPO) transactions, while standing facility for the same was made available only on days when there was a liquidity shortfall and only up to the estimated shortfall.



Licensed commercial banks continued to be the eligible Participating Institutions (PIs) in OMO activities. In addition, primary dealers who had been excluded from OMO activities since 19 June 2006 were re-enlisted as eligible PIs with effect from 23 August 2007.

The Central Bank's policy rates, i.e., the REPO and Reverse REPO Rates, were increased by 50 basis points each to 10.5 per cent and 12 per cent, respectively, in February 2007 and maintained at the same level throughout the rest of the year.

The overall liquidity position in the banking system, on average, remained at a surplus level during the year (Chart II - 1). The liquidity surplus in May, increased substantially from its average of about Rs. 5 bn. in the previous months to about Rs. 12.5 bn.,



mainly due to the return of currency after the heavy draw down of same to meet the festive demand and net foreign loan disbursements. The liquidity surplus in November, on average, increased to more than Rs. 8 bn. due to the inflow of foreign funds from the issue of international Sovereign bonds of US\$ 500 mn. by end October. Meanwhile, there were significant liquidity shortages on most of the days in April, September and October, mainly due to the high demand for currency during the festive season, sale of foreign currency by the Central Bank and repayment of foreign loans.

### (i) Daily Auctions Under OMO

#### REPO Transactions

The DOD continued to conduct auctions for REPO transactions in order to absorb any temporary liquidity surplus in the banking system on a daily basis. The excess liquidity recorded on most days during the year was absorbed through daily auctions by selling Treasury bills on a repurchase basis. On average, about Rs. 7.4 billion, which represented nearly the estimated liquidity surplus, was offered to the auction on a daily basis. The amount absorbed from these auctions, on average, was about Rs. 6.1 billion and represented 80.2 per cent of the estimated liquidity surplus. The weighted average yield rate of the auctions, which were around 11.35 per cent at the beginning of the year, increased by about 50 basis points following the increase in policy rates in February and stood at around 11.87 per cent by the end of the year (Chart II - 2).

#### Reverse REPO Transactions

Reverse REPO auctions were not held during the year 2007.

### (ii) Standing Facilities

PIs, which were unable to manage their short-term liquidity requirements fully through the inter-bank money market and the daily OMO auctions, were provided the opportunity of obtaining standing

facilities. These facilities were provided at the REPO and Reverse REPO rates of the Central Bank.

### **REPO Transactions**

PIs that were not successful or unable to participate at the REPO auction resorted to investing in the standing facility at the REPO rate of the Central Bank. Since the major portion of excess liquidity was absorbed by conducting daily auctions for REPO transactions under the OMO, REPO transactions under the standing facility were limited, on average, to about Rs. 0.75 billion per day.

### **Reverse REPO Transactions**

The Reverse REPO Facility (RRF) of the Central Bank under the standing facility is made available to PIs in order to meet their temporary liquidity needs only as a last resort. However, since it was observed that certain banks utilised the standing facility as a regular source of funding even when there was a liquidity surplus in the system, PIs were advised to limit the use of the RRF under the standing facility and confine their operations to the resources available.

In order to discourage the use of RRF, the Central Bank decided to make this facility available only on days when there is a liquidity shortfall in the system, with effect from January 2007. In addition, the total amount provided by the Central Bank under the RRF on a particular day was limited to the liquidity shortage in the system as per the Bank's estimates. The RRF was made available to a particular bank only up to six times per calendar month until 31 March 2007 and up to three times per calendar month thereafter, at the Reverse REPO rate of the Central Bank. The restrictions on the number of times that a particular PI could borrow under the RRF during a month were withdrawn on 23<sup>rd</sup> August 2007.

In order to strike a balance between the need for discouraging the excessive use of the RRF and meeting the liquidity requirements of PIs, the Central Bank subsequently decided to provide the RRF, at the reverse REPO rate, up to four times per calendar month per participant and beyond this limit at a penal rate of 19 per cent per annum, which is to be reviewed periodically and changed in accordance with the prevailing monetary conditions, with effect from 3<sup>rd</sup> December 2007.

As a consequence of the measures implemented by the Central Bank, the use of the RRF under the standing facility had declined substantially from Rs. 382 billion in 2006 to Rs. 173 billion during the year 2007.

### **(iii) Outright Transactions**

The Central Bank conducted outright auctions to sell Treasury bills out of its own portfolio, in order to absorb excess liquidity on a permanent basis. The Bank commenced to conduct multiple maturity auctions to sell Treasury bills in January 2007. The total value of Treasury bills sold through these auctions during the year amounted to Rs. 110.9 bn. The tenure of these bills was very short-term with the remaining days to maturity ranging from 10 to 157 days. These sales were at yield rates, which were below the rates comparable with prevailing weighted average yield rates for 91 day Treasury bills in the primary market at the time of each outright sale.

#### **(b) Statutory Reserve Requirement (SRR)**

The department continued to enforce the SRR, which was stipulated at 10 per cent of deposit liabilities of commercial banks, denominated in Sri Lanka rupees.

#### **(c) Bank Rate**

The Central Bank's rate of interest (Bank rate) on short term advances to licensed commercial banks, stipulated under Section 87 of the Monetary Law Act, remained unchanged at 15 per cent. However, this rate was inoperative as no bank resorted to borrowing from the Central Bank at the Bank rate.

## **6.2 Functioning as Banker to Commercial Banks and the Government**

### **(a) Accounts of Financial Institutions**

In order to facilitate the Central Bank's role of being the Banker to commercial banks, the department continued to provide current account facilities to commercial banks and primary dealers to ensure an efficient inter-bank payment and settlement system. These accounts were operated on a Real Time Gross Settlement (RTGS) basis within the automated general ledger system of the Bank.

### **(b) Government Accounts**

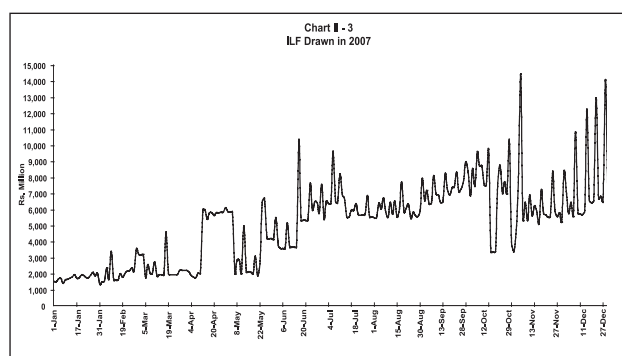
In functioning as the Banker to the government, the department maintained the accounts of government departments, government agencies and institutions and certain statutory boards, providing them with required banking facilities. As at end December 2007, the total number of such accounts maintained by the Bank amounted to 38. One new account was opened, whilst one was closed during the year at the request of the government. The Bank continued to provide provisional advances to the government, free of interest, in terms of Section 89 of the Monetary Law Act. The limit on such advances (10 per cent of the estimated government revenue) was increased by Rs. 12.2 bn. to Rs. 62 bn. in 2007.



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

Commercial banks and primary dealers were provided the ILF, to ensure the smooth and efficient operations of the RTGS system. The ILF was provided free of charge against the collateral of Government Treasury bills and bonds. These securities were valued at their current market prices with a sufficient hair cut added to cover for any variations in prices during the day.

The total value of ILF drawn during the year amounted to Rs. 1,222 bn. in comparison to Rs. 538.6 bn. during the preceding year. The average value of ILF drawn per day was about Rs. 5.03 bn. (Chart II – 3). There were no ILF defaults during the year. Strong measures in place including a penalty interest at the Bank rate and the suspension of the facility for repeated defaults have ensured the prompt reversal of ILF before the close of business of LankaSettle.



## 7. ECONOMIC RESEARCH

The Economic Research Department (ERD) continued its functions as the ‘Economic Think Tank’ in the Central Bank with the mandate of conducting economic research in formulating, implementing and executing policies and measures, while disseminating information to the public. During the year, in carrying out this vital responsibility, ERD undertook policy oriented economic research, while collecting and analysing economic and social statistics as essential inputs for monetary policy formulation and for guiding the Monetary Board, the monetary policy decision maker. These analyses enhanced knowledge and were supportive of improving the understanding of various issues to gain better policy outcomes. The Department was actively engaged in the new measures introduced by the Central Bank on the monetary policy front, while providing its expertise to a number of other initiatives commenced by the government during the year. In addition, ERD provided policy advice on economic issues to the government and various other stakeholders. It continued to disseminate economic and financial

information for the benefit of the general public, mainly through the statutory publications, regular and time to time press releases, and weekly and monthly indicators published in the press as well as in the Central Bank website.

The formulation and implementation of the monetary policy was the primary focus of the evidence based research activities conducted by ERD. In addition, other domestic and international developments and policies were also analysed to facilitate the design and implementation of appropriate policies in line with broad macroeconomic objectives of the country. These efforts were particularly directed towards performing ERD’s vital role in facilitating and strengthening the deliberations of the Monetary Policy Committee (MPC). After incorporating the views and concerns of MPC, the board papers prepared by ERD were submitted to the Monetary Board for the purpose of monetary policy decision making. Moreover, regular updates on the state of the economy were also submitted to keep the Monetary Board informed of the latest developments in the economy.

In addition, economic research activities were also continued on subjects of contemporary importance. Among those, the following research papers, completed in 2007 and edited by ERD, are to be published in the Bank’s Staff Studies.

- (a) “Intra Day Liquidity Facility: Does it have an impact on Monetary Policy?” by Dr. D. S. Wijesinghe
- (b) “Regulatory Practices of Money Broking Business in Selected Countries” by Mrs. Rupa Dheerasinghe
- (c) “Exchange Rate Pass-Through: To What Extent do Prices Change in Sri Lanka?” by Ms. S. M. Wimalasuriya
- (d) “Monetary Policy and Inflation Performance: Evidence from Exchange Rate Regimes in Sri Lanka” by Mr. P. K. G. Harischandra

ERD prepared the public policy statement of the Central Bank, the “Road Map for Monetary and Financial Sector Policies for 2007 and Beyond” (Road Map-2007), which was announced to the stakeholders on 2<sup>nd</sup> January, 2007. It contained an analysis on the developments in the economy and the conduct of monetary and financial sector policies in 2006, and challenges in meeting monetary policy objectives and financial stability in 2007, with a view to enhancing the policy predictability and transparency. A similar policy statement was prepared

for 2008 as well, and announced on 02<sup>nd</sup> January, 2008.

As per Road Map-2007, a Monitoring Mechanism of Key Macroeconomic Variables was introduced by ERD to monitor the trends of several selected variables in external, fiscal and monetary sectors in the economy to minimise the deviations from the given targets and to ensure that early policy measures would be taken to avoid any significant deviations. ERD coordinated the work related to the Monetary Policy Consultative Committee (MPCC) established to further strengthen the monetary policy decision making process, through the expertise and insight of outside experts. The MPCC, which comprises of Prof. A. V. D. de S. Indraratne (Chairman), Mr. Sohli Captain, Mr. Yohan Perera, Mr. Mahen Dayananda, Mr. R. M. B. Senanayake, Mr. M. P. Jayawardena and Mr. Cubby Wijetunge met on a monthly basis to review economic developments and make valuable contributions to enhance the monetary policy decision making process. Members have been reappointed to the MPCC in 2008 with a view to benefit from their expertise during 2008 as well.

In providing pro-active policy advice to the government, ERD submitted a number of policy papers to the Monetary Board. The Department was actively involved in preparing various papers and presentations to the National Economic Council (NEC). ERD was also engaged in providing independent views on economic implications of Cabinet Papers dealing with policy matters, which is a new responsibility vested with the Department. In addition, ERD continued to evaluate the terms and conditions of all foreign loans obtained by the government from multilateral and bilateral development partners and commercial sources to assess their monetary implications. The questions on various economic issues, raised from time to time by Members of Parliament, were also responded to by ERD.

During the year, ERD interacted with several institutions and explored various avenues by which the country's growth potential could be enhanced. These include the analyses on oil exploration in Sri Lanka and related areas and promoting an Exclusive Economic Zone (EEZ) as a path for the development of the fisheries sector in the country. The ERD was also represented in the "Committee on Expansion of Electricity Generating Capacity" and the "Committee on Reviewing the Overall Tariff Policy of Ceylon Electricity Board" set up by the Ministry of Power and Energy. Further, ERD played a key role in promoting hedging of oil imports by the Ceylon

Petroleum Corporation to reduce the adverse impact of high volatility in oil prices. ERD also actively engaged in organising the Seminar on "Balanced Regional Development", organised jointly by Central Bank and Finance Commission.

The officials of the department rendered their services to several Cabinet Appointed Committees on economic matters and various other internal and external Committees and Boards. The ERD officials participated in the negotiations in the Sub-Group on Financial Services under Sri Lanka-India Comprehensive Economic Partnership Agreement (CEPA). They also served as resource persons in training programmes conducted by the Centre for Banking Studies (CBS) and other local and foreign institutions. The officers provided assistance to post-graduate degree aspirants of the Bank by guiding them on their research work and evaluating their research papers. They also participated in programmes organized by television and radio stations on current issues, particularly in the educational television programmes conducted by CBS, especially for the benefit of Advanced Level students. Structured presentations were also made to various stakeholders including parliamentarians, diplomats, media, government officials, investors, foreign parties and the general public to improve awareness and to clarify misconceptions on the Sri Lankan economy.

The Department contributed significantly to the debut international bond issue of the government, which was successfully completed in October, 2007. In particular, ERD contributed in the preparation of Offer Document and Road Show Presentation related to the bond issue, while ERD officials also represented the Sri Lankan delegation engaged in promotional activities abroad.

The preparation and publication of statutory reports in all three languages was continued by ERD as a primary responsibility. Accordingly, the publication of the Bank's Annual Report for 2006, Recent Economic Developments – Highlights of 2006 and Prospects for 2007, and Monthly Bulletins were coordinated by ERD. In addition, ERD published another report titled "Recent Economic Developments and Credit Trends" to improve the awareness of investors on the latest developments in the economy. The Department was also responsible for the preparation of the September 15<sup>th</sup> Report, a confidential report submitted by the Bank under the provisions of the Monetary Law Act (MLA) to the Minister of Finance prior to the preparation of the government budget. In complying with its

responsibility of disseminating information, ERD continued to issue regular press releases on Monetary Policy and International Trade on a monthly basis during 2007. In addition, press releases were issued, from time to time, to explain and clarify various economic developments and issues.

ERD continued to promote relationships with other international organisations on behalf of the Central Bank and the government. Accordingly, coordination work related to the annual IMF Article IV Consultation missions, the inter-governmental Group of Twenty Four (G-24), the SEACEN Centre for Research and Training, and the SEANZA group were conducted by ERD. It worked closely with the international sovereign rating agencies like Fitch Ratings and S&P Ratings Services. Assistance was also extended to the Ministry of Finance and Planning in the process of coordination of activities with the World Bank, the Asian Development Bank and other multilateral and bilateral development partners.

## 8. EMPLOYEES' PROVIDENT FUND

The operations of the Employees' Provident Fund Department facilitate the Monetary Board to perform its powers, duties and functions under provisions of the Employees' Provident Fund Act. In terms of the Act, the Monetary Board being the custodian of the Employees' Provident Fund, is entrusted with powers, duties and functions in respect of management of the Fund which mainly include collection of member-contributions and surcharges, maintenance of member-accounts, investment of surplus funds, charging to the income of the Fund the expenditure incurred by the Monetary Board and Commissioner of Labour in the performance of their duties and functions under the Act, payment of benefits to beneficiaries of the Fund and compilation of financial statements of the Fund and submission of the same to the Hon. Minister of Labour within three months from the end of December each year. The Department carried out the above activities during 2007 in terms of the policies approved by the Monetary Board and in close co-ordination with the Commissioner of Labour.

### 8.1 Membership, Member Balances and Refunds

The Fund (total liability to members) as at end of 2007 stood at Rs. 546.4 billion registering an increase of 14 per cent or Rs. 68.8 billion from its level of Rs. 477.6 billion as at end of 2006 (see Table II-1). This growth of the Fund was attributable to the increase in the number of members and their contributions during the year. The total number of member accounts increased to 11.9 million, comprising of

nearly 2.1 million contributing-member accounts. Meanwhile, net contributions, i.e., contributions less refunds to beneficiaries, registered an increase of Rs. 18.8 billion during the year when compared to an increase of Rs. 17.5 billion during the previous year. The refunds to beneficiaries during the year amounted to Rs. 21.7 billion, showing a 24.7 per cent increase while the number of refunds increased only marginally.

**Table II-1**  
**The Basic Information of the Fund**

Item	2006	2007	Change (%)
1. Total number of member accounts'000	11,326	11,850*	4.6
1.1. Contributing member accounts'000	2,073	2,147*	3.5
1.2. Non-contributing member accounts'000	9,252	9,703*	4.9
2. Contributing employers	57,996	60,496	4.3
3. Total contributions (Rs.mn)	34,933	40,574	16.1
4. Total refunds (Rs. mn)	17,448	21,752	24.7
5. Number of refunds	97,620	97,936	0.3
6. Total liability to members (Rs. bn)	477.6	546.4	14.4
7. Total value of the Fund (Rs. bn)	490.4	560.4	14.3

\* Estimated

Source: Employees' Provident Fund

### 8.2 Investments of Funds and Return

**a. Investments Portfolio:** Investment strategy of the Fund was mainly to ensure long-term growth with safety of funds because of the Fund being the retirement-benefit scheme. Therefore, as in the previous years, investments were made in more secured securities. The total investment portfolio of the Fund grew by 13.3 per cent to Rs. 535 billion as at end 2007 from Rs. 472 billion as at end 2006 (Table II-2). As in the previous year, investments portfolio was maintained mainly in Government securities (96.5 per cent). Investments in corporate debentures and equities stood at 2.7 per cent of total portfolio in line with the Fund's investment policy. For liquidity purposes, investments in high liquid assets such as repos (0.8 per cent) were also maintained at a desirable rate.

**b. Revenue:** Total income on investments registered an increase of 28 per cent from Rs. 46.3 billion in 2006 to Rs. 59.4 billion in 2007 (see Table II-3). As in the past, the interest income including amortization gain was the major source of income to the Fund. In 2007 interest income grew by Rs. 14.2 billion to Rs.59.3 billion from Rs.45.2 billion in 2006. Interest income on average interest bearing asset portfolio increased to 12.6 per cent in 2007 from 11.0

per cent in 2006 in line with the upward trend in the market interest rates. However, the realized income on equity portfolio through capital gain and dividend marginally declined to Rs.429 mn in 2007 from Rs. 440 mn. in 2006 due to depressed market conditions. The rate of return on the average equity portfolio was 8.3 per cent as against 13.0 per cent in 2006. Overall, the rate of return on average investment portfolio in 2007 rose to 12.7 per cent, reflecting an increase of 1.4 percentage points as compared with the rate of return of 11.3 per cent in 2006.

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

Type of Investment	2006		2007	
	Rs. bn	Share, %	Rs. bn	Share, %
Treasury bonds & bills	401.1	85.0	447.0	83.6
Rupee Loans to Government	56.1	11.9	68.9	12.9
Corporate Debentures	7.0	1.5	7.9	1.5
Equity	3.6	0.8	6.7	1.2
Repos and Other	4.0	0.8	4.3	0.8
<b>Total</b>	<b>471.8</b>	<b>100.0</b>	<b>534.8</b>	<b>100.0</b>

Source: Employees' Provident Fund

**Table II- 3**  
**Income on Investment**

Source of Income	2006		2007	
	Rs. mn	Share, %	Rs. mn	Share, %
Interest	44,104	95.1	49,885	84.0
Dividends	120	0.3	146	0.2
Capital Gain	1,017	2.1	288	0.5
Amortized Gain (Net)	1,073	2.3	8,944	15.0
Other	77	0.2	158	0.3
<b>Total Income</b>	<b>46,391</b>	<b>100.0</b>	<b>59,422</b>	<b>100.0</b>

Source: Employees' Provident Fund

**c. Expenses :** The total operating expenditure of the Fund was maintained below 1 per cent of gross income during 2007 although the expenditure increased by 28.5 per cent to Rs.546 million in 2007 from Rs. 425 million in 2006 (see Table II-4).

**Table II- 4**  
**Operating Expenditure** (Rs. Mn)

Expenditure Items	2006	2007	% Change
1. Personnel expenses	259.9	318.2	22.4
2. Administration expenses	159.0	211.0	32.7
3. Financial expenses	6.2	16.9	172.6
<b>4. Total expenses</b>	<b>425.1</b>	<b>545.1</b>	<b>28.5</b>
<b>5. Total expenses as a % of gross Revenue</b>	<b>0.92</b>	<b>0.90</b>	<b>0.02</b>

Source: Employees' Provident Fund

The total operating expenditure of the Fund (excluding the expenses on re-registration project amounting to Rs. 13.1 million.) was 0.90 per cent of the gross income in 2007, as compared to 0.92 per cent in 2006.

### 8.3 Payment of Interest on Member Balances

In 2007, a sum of Rs. 55,240 mn was available for distribution as interest to the members of the Fund (see Table II-5). As a result, interest payments to member balances stood at a rate of 11.2 per cent on total member balances (amounting to Rs. 493,211 million as at end 2007), which was 1.1 per cent higher than the previous year's interest rate of 10.1 per cent. However, in view of the practice of paying interest on the year-end balance for the full year, the effective rate of interest<sup>1</sup> is estimated at 11.40 per cent for the year 2007.

**Table II- 5**  
**Payments of Interest to Members** (Rs. Mn)

Item	2006	2007	% Change
<b>1. Gross revenue</b>	<b>46,391</b>	<b>59,422</b>	<b>28.1</b>
2. Total operating expenses	425	546	28.5
3. Income tax	2,761	4,451	61.2
4. Net Income available for distribution	47,710	54,612	14.5
5. Distribution of net income			
5.1 Transfers to reserves	3,100	-	-
5.2 Interest paid on current refunds	622	879	41.3
5.3. Interest paid on member balances	43,786	53,515	26.2
5.4 Carry forward balance	201	218	8.1
6. Interest paid out of reserves on member balances	-	1,725	-
7. Interest rate paid on member balances, %	10.10	11.20	1.10

Source: Employees' Provident Fund

On average, real rate of interest (the average effective interest rate on member balances minus the country's inflation rate as measured by the annual average rate of increase in Colombo Consumers' Price Index) accrued to the member accounts during the last decade was around 1.25 per cent.

### 8.4 Member Account Statements

The member-account statements for the second-half of 2006 were issued to members through their employers during September 2007. Arrangements have been made to issue account statements for the first half of 2007 by end of June 2008.

### 8.5 Housing Loan Facility

The housing loan scheme, which was introduced in 1998, continued during the year. Accordingly, the Dept. issued 12,969 member balance certifications to lending institutions for approval of housing loans amounting to Rs. 2,872 million to members. (see Table II-6). Meanwhile, as a result of the high rate of loans in arrears, nearly Rs.1,078 million was deducted during 2007 from relevant member accounts and

<sup>1</sup> Effective Interest Rate = Interest Paid to members / [(Beginning year member balances + End year member balances) / 2]



remitted to the lending institutions to settle the principal and interest in arrears for the year 2006.

**Table II-6**  
**Details of Housing Loan Facility** Rs.(mn)

Year	Certifications Issued (No)	Credit Approved	Amount Remitted by the EPF to lending Institutions
2003	18,689	2,792	670
2004	14,307	2,452	735
2005	14,600	2,766	900
2006	15,136	3,049	1,078
2007	12,969	2,872	1,240

Source: Employees' Provident Fund

## 8.6 Public Awareness

During the year, the Dept. continued to enhance the public awareness on the operations of the Fund. Two mobile services (Water Board at Ratmalana and Hotel sector employers at Negombo), two seminars for employers (Nuwara Eliya and Kegalle and participation in two public exhibitions (Dayata Kirula, Nuwara Eliya) and HR Managers Conference were organized by the Institute of Personnel Management at BMICH during 2007. Meanwhile, several press advertisements were issued to inform the members of half-yearly member account statements, the project for re-registration of current members and annual financial statements of the Fund.

## 8.7 System Improvements

The implementation of the new accounting and investment package (SAP system), which was introduced in 2006 to carry out functions such as accounting, investment, procurement and material management and budgeting and budget control, continued in 2007. The Dept. also facilitated the Labour Department to commence a joint project in October 2007 to re-register the members by their names appearing in the National Identity Card (NIC), assigning the NIC number as their member number and amalgamating their previous member accounts, if any. The objective of the re-registration project is to change the system to a "Member Centric System" (i.e., implementation of unique numbering system for the members) by end of 2008 from the present "Employer Centric System". With a view to providing a better service to members, the Department improved the services provided at Help Desk and the Inquiry Counter by strengthening manpower and infrastructure facilities. The Dept. continued to promote the process of receiving the information on member contributions electronically during 2007. As a result, 76 new employers joined the system, increasing the total number of such employers to 340 in 2007 from 264 in 2006.

## 9. EXCHANGE CONTROL

The Exchange Control Department (ECD) carries out the exchange control function of the Central Bank as the agent of the Government in administering the provisions of the Exchange Control Act No.24 of 1953 as amended. Accordingly, the major activities of the ECD carried out during the year 2007, included issuance of Directions/Operating Instructions to authorized dealers and others, granting approvals for foreign exchange transactions, surveillance on various foreign exchange transactions and investigations into violations of the provisions of the Exchange Control Act.

### 9.1 Issuance of new Directions/Operating Instructions

The ECD issued several new Directions/Operating Instructions to Authorized Dealers (licensed commercial banks) and other parties in 2007. A summary of such Directions/Operating Instructions is as follows: Details of these Directions/Operating Instructions are given in Part III of this report.

- (a) **Permission for third party deposits to Non-Resident Foreign Currency Accounts (NRFC Accounts):** Authorized Dealers and licensed specialized banks who have been permitted to maintain NRFC Accounts were permitted to accept third-party foreign currency deposits to NRFC accounts subject to a limit of US\$ 1,000 per transaction or its equivalent in other convertible foreign currency from immediate family members of the NRFC Account holders. This facility was introduced to promote inward remittances through the banking sector.
- (b) **Fixed deposits for Dual Citizenship Applicants:** Authorized dealers were permitted to open foreign currency fixed deposit accounts for dual citizenship applicants to obtain exemption from payment of any fee to the government on account of granting dual citizenship for his family members, provided that the deposit should not be less than US\$ 50,000 or its equivalent in other convertible foreign currency maintained for a minimum period of 3 years.
- (c) **Increase of foreign currency component of the travel allowance:** The issuance of foreign currency notes as a part of the travel allowance for Sri Lankans travelling abroad was increased to US\$ 1,000 from the level of US\$ 500 mainly to ease difficulties encountered by travellers in encashing traveller's cheques in some foreign countries.

- (d) **Issuance of foreign currency notes by Money Changers:** Nine Money Changers who recorded a minimum annual turnover of US\$ 4.0 mn each were permitted to issue foreign currency notes for Sri Lankans travelling abroad up to a limit of US\$ 1,000 or its equivalent in other convertible currency per transaction.
- (e) **Permission for investments in Rupee Denominated Treasury bonds:** Foreign Country Funds, Regional Funds and Mutual Funds approved by the Securities and Exchange Commission of Sri Lanka, Corporate bodies incorporated outside Sri Lanka and citizens of foreign states were permitted to purchase and hold Rupee denominated Treasury bonds up to a level of 10 per cent of the total value of Treasury bonds outstanding at any given point of time.
- (f) **The declaration limits for foreign currency at Sri Lanka Customs:**
- The declaration limit to Sri Lanka Customs on foreign currency (i.e., bringing into Sri Lanka) by a person was increased to US\$ 15,000 or its equivalent in other convertible foreign currency from the level of US\$ 10,000;
  - It was also made a requirement to make a declaration to Sri Lanka Customs all foreign currency notes brought in by a person if the person intends to take back foreign currency in the form of foreign currency notes exceeding US\$ 5,000;
  - The value of foreign currency permitted to take out by a person resident in Sri Lanka was maintained at US\$ 10,000 or its equivalent in other convertible foreign currency without declaring to the Sri Lanka Customs. However, he/she should make a declaration to Sri Lanka Customs if the value of foreign currency so taken in the form of currency notes exceeds US\$5,000 or its equivalent in other convertible foreign currency.
- (g) **Foreign Currency Accounts for Resident Guests:** Two new foreign currency account schemes, namely, Resident Guest Foreign Currency Account (RGFCA) and Resident Guest Rupee Current Account (RGRCA), were introduced to foreigners who obtain visas under the Resident Guest Scheme. The RGFCA is mainly to channel investment funds to the country while RGRCA is to meet expenses to be incurred by family members of the Resident

Guest out of funds brought into the country for family maintenance.

## 9.2 Approval for Investment Abroad and Foreign Borrowing

The ECD processed requests for approval of investments abroad and foreign borrowings and granted approvals for 47 requests highlighted below in terms of the relevant provisions of the Exchange Control Act:

- (a) Approvals for 30 resident companies to invest abroad amounting to US\$ 145.1 million mainly in the areas of hotel & tourism, establishing exchange houses, trading & shipping and employee share option schemes;
- (b) Approvals for 17 resident companies to borrow from abroad to a total sum of approximately US\$ 126.1 million.

## 9.3 Issuance of permits/licences to Freight Forwarders, Money Changers and Restricted Dealers

The ECD continued to issue permits to Freight Forwarders, Money Changers and other Restricted Dealers as indicated below:

- (a) 38 new companies were registered as Freight Forwarders bringing the total number of Freight Forwarders to 248 at the end of 2007;
- (b) Two new licences were issued to companies registered in Sri Lanka to engage in money changing business bringing the total number of money changers to 66. The required minimum annual turnover to qualify for the renewal of the money changer permit was increased from US\$ 120,000 to US\$ 600,000;
- (c) 49 new permits were issued to other restricted dealers such as duty free shops, tourist hotels, travel agents and gem and jewellery shops bringing the total number of such restricted dealers to 3,398.

## 9.4 Surveillance on Foreign Exchange Transactions

The ECD continued to strengthen its surveillance on foreign exchange transactions through periodical returns submitted by relevant parties with a view to promoting compliance with the provisions of the Exchange Control Act as follows:

- (a) Monitoring of foreign exchange transactions of authorized dealers, approved travel agents and money changers through periodical reports submitted by them on supply and absorption of foreign currency by way of on-line, e-format and

submission of hard copies of Form 1 (*report on sales of foreign exchange*) and Form 2 (*report on purchases of foreign exchange*). With the introduction of e-format in 2007, the ECD intends to receive all the information (100 per cent) on-line for efficient data retrieval;

- (b) Installation of a software package to improve the reporting of the foreign exchange transactions by money changers;
- (c) Monitoring of transactions of Electronic Fund Transfer Cards (EFTCs) to detect unauthorized capital transfers and funds connected with financing of terrorism or money laundering activities;
- (d) Introduction of e-mail reporting facility for exporters to enhance the effectiveness and response with regard to monitoring export proceeds;
- (e) On-line monitoring of operations of Share Investment External Rupee Account (SIERA) and Treasury bond Investment External Rupee Account (TIERA).

### 9.5 Investigations into violation of the Provisions of the Exchange Control Act

As in the previous years, investigation into alleged violations of the provisions of the Exchange Control Act by various parties such as authorized dealers, individuals and corporate was a major activity of the ECD in 2007. Nearly 110 investigations were carried out in 2007. Of those, 46 investigations were concluded during the year and a sum of Rs.14.0 mn. was collected as penalties imposed on the parties. Investigations mainly included violations of provisions identified in the areas of making unauthorized funds transfers by local companies, holding and placing foreign currency on behalf of residents outside Sri Lanka, obtaining foreign currency loans without prior approval and investing in equity in foreign companies without prior approval.

### 9.6 Other Activities

The ECD made efforts to promote the worker remittances through the banking and other formal sectors. In this regard, two awareness programmes were conducted for officers of commercial banks and family members of migrant workers at Matale and Madampe. In addition, a series of meetings were held with the officials of commercial banks, specialized banks and officers of the Association of Licensed Foreign Employment Agencies to explore the strategies to enhance worker remittances and discourage use of unauthorized fund transfer arrangements.

## 10. FINANCIAL INTELLIGENCE UNIT

The Financial Intelligence Unit (FIU) which was established in March 2006 under the Financial Transactions Reporting Act No.6 of 2006 functions as a unit in the Central Bank in terms of the order made by H.E the President under the Act to be the institution designated to operate the FIU. The FIU was reorganized to be a Department in the Central Bank in February 2007 in order to enhance its operations and to act efficiently to discharge its statutory functions by leveraging on the policy-making and regulatory capabilities of the Central Bank. The main functions of the FIU are the collection and receipt of information relating to financial transactions and unlawful activities as defined in the Act, conduct of investigation into suspicious activities on the basis of such information, dissemination of such information and details of investigations to law enforcement authorities and relevant regulatory authorities to institute legal or enforcement action against suspicious parties and issue of regulations to prevent the parties from using the financial system to engage in unlawful activities. During the year 2007, the FIU focused its operations mainly in the areas of combating money laundering and terrorist financing through financial institutions.

### 10.1 Collection of information and investigations

In terms of the requirements imposed by the FIU, Licensed Commercial Banks (LCBs), Licensed Specialised Banks (LSBs) and Registered Finance Companies (RFCs) continued to report all cash transactions and electronic fund transfers exceeding Rs. 500,000 or its equivalent in foreign currency and suspected transactions relating to money laundering and terrorist financing activities that are not subject to any threshold. As at the end of the year 2007, the data base of the FIU contained about 3 million such transactions reported by the financial institutions. Accordingly, the FIU continuously undertook a number of preliminary analysis and investigations into certain financial transactions to identify any links to money laundering and terrorist financing through financial institutions. In addition, investigations through the law enforcement authorities continued on the suspected transactions in connection with the bank accounts suspended in 2006 and 2007. Further, the FIU assisted a number of local and international agencies by providing/disseminating relevant information with regard to investigations into money laundering and terrorist financing activities.

### 10.2 Issue of Directions/Regulations

The FIU issued the following Rules/Directions and these are given in details in the Part III of this Report.

- (i) Rules on “Know Your Customer and Customer Due Diligence” to LCBs, LSBs, RFCs and Securities Industry. These rules require the financial institutions to have detailed information on customers and the nature and sources of their financial transactions. Further, rules to be issued to the institutions engaged in insurance and money exchange services have already been drafted.
- (ii) In order to combat offences against children, a directive was issued to the banks requesting them to institute additional KYC/CDD measures for the usage of Child Pornography Websites and related electronic payments. Accordingly, banks were requested to report suspicious transactions of any customer, transaction or merchant involved in offences against children.
- (iii) A number of directives have been issued to the LCBs and RFCs to strengthen the AML/CFT activities of the country. Submission of periodical reports and reporting of electronic funds transfers are among them.

### 10.3 Other activities

The FIU carried on several other activities to promote its functions and operations during the year as highlighted below.

- (i) **Signing a Memorandum of Understanding (MOU) with the Central Bank in Malaysia (Bank Negara Malaysia):** MOUs for exchanging of information relating to suspicious transactions is necessary since unlawful activities such as money laundering or terrorist financing are undertaken by internationally organized parties and terrorist organisations through cross boarder transactions. This has resulted in the prevention of the financial system being used for such activities jointly with greater cooperation and coordination. The Central Bank plans to sign such MOUs with other overseas authorities in future.
- (ii) **Conducting various meetings:** In order to enhance the efforts in combating money laundering and terrorist financing, a series of meetings were conducted with the compliance officers of the LCBs, LSBs and RFCs. Further, regular meetings with law enforcement agencies in Sri Lanka and with foreign missions of UK, USA, France, Asia Pacific Group on Money Laundering and Commonwealth Secretariat were held to enhance the cooperation and to develop the FIU activities.

- (iii) **Setting up a Legal Reform Committee** comprising members of Attorney General’s Department, Legal Draftsman’s Department, Legal Department of the CBSL and FIU to review/revise the existing legislations.

- (iv) **Capacity building and awareness programmes:** A number of workshops and awareness programmes on anti-money laundering and terrorist financing activities were conducted in 2007. This included several workshops jointly organized by the FIU with the Sri Lanka Banks’ Association, Securities and Exchange Commission, The World Bank, Commonwealth Secretariat and Asia Pacific Group on Money Laundering for Financial Institutions, Prosecutors, Customs and officials of the Criminal Investigations Department. Further, the FIU also assisted the Lakshman Kadirgamar Institute of International Relations and Strategic Studies in hosting an international conference on countering terrorism in October 2007 in Colombo. In addition, 21 awareness programmes for banks, finance companies and educational institutions and four Public Seminars in Western, Central, North Central and Southern Provinces were conducted. One-page newspaper advertisement in Sinhala, English and Tamil was also issued as a part of the public awareness programme. These programmes were intended to make the public aware of the dangers of getting involved in transactions with parties to assist unlawful financial transactions and detrimental effects of such transactions to the public or national interest and the country’s security situation at large.

## 11. FINANCIAL SYSTEM STABILITY

The Financial System Stability Department (FSSD) was established in January 2007 to focus on maintaining financial system stability, which is one of the objectives of the Central Bank. This entails ensuring that Sri Lanka’s financial system is safe and threats to financial stability are detected and reduced. Hence, the main functions of the department are to identify risks to the financial system at an early stage, to implement preventive and remedial policies to avoid financial instability and to assist in resolving crises when other measures fail. A forward-looking approach is pursued to identify the potential build-up of financial imbalances and vulnerabilities.

The financial system in Sri Lanka comprises financial institutions, such as, commercial banks, specialized banks, finance companies, leasing companies,



primary dealers, insurance companies and brokers, stock brokers, pension and provident funds and micro-credit institutions, financial markets, such as the money market, bond market, foreign exchange market and the equity market and financial infrastructure, consisting of payment, settlement and trading systems.

The FSSD adopts a system-wide approach to monitor and analyze developments in all areas of the financial system. This entails surveillance of developments in the macro and real economy, domestic and international financial markets, systemically important financial institutions and functioning of the main financial infrastructure. The FSSD assesses a range of aggregate financial and economic data which help gauge the soundness of the financial system and potential vulnerabilities. These include a broad range of quantitative financial stability and soundness indicators, relating to the macro-economy, deposit-taking institutions, other financial institutions, the corporate and household sector. These indicators assess the health of the financial sector and act as an early warning system to alert authorities and participants of potential risks.

The FSSD is also responsible for the production of the Financial System Stability Review (FSSR) which is published annually. The FSSR provides an assessment of Sri Lanka's financial system and the risks facing it. The FSSR also includes the actions that should be taken to promote financial system stability. The purpose of the FSSR is to provide information to financial institutions and market participants to enable them to prepare for and to manage risks and to encourage awareness and debate on issues affecting financial system stability. The FSSR 2007 was released in November 2007.

The FSSD also functions as the secretariat for the Financial System Stability Committee (FSSC) which is chaired by the Deputy Governor in charge of financial system stability. The FSSC meets monthly and reports to the Monetary Board on financial system stability.

## 12. HUMAN RESOURCES MANAGEMENT

During the year 2007, Human Resources Department (HRD) diverted its resources and energies to complete the recruitment process with a view of fulfilling the identified competency gaps. In addition, the department carried out its other functions such as promotions, placements, succession planning, performance evaluation and job rotations in line with the human resource needs identified by the Bank. Simultaneously, HRD also adopted a strategic orientation to improve employee motivation with a

view of achieving the goals and objectives of the Bank.

### Recruitment

The new recruitments in 2007 were aimed at meeting competency requirements and filling the identified vacancies in various departments. A total of 59 Management Trainees were recruited on two year training period and 2 Maintenance and Project Engineers were recruited to Staff Class Grade II while 8 English Steno/Typists and 2 IT Technicians were recruited on contract basis during the year.

### Promotions

Career progression of all employees of CBSL was considered when grade promotions and position promotions were granted in 2007. Marks of performance evaluations and the recommendations made by heads of department were used as criteria for grade promotions. On this basis, 138 officers in Staff Class, Non-Staff Class and Minor Employee categories were promoted in 2007. In the case of position promotions, 3 Heads of Department were promoted to Staff Class Special Grade and designated as Assistant Governors and 11 Deputy Heads of Department were promoted to Staff Class Grade IV. Fifty three (53) Staff Class Grade III officers were designated as Deputy Heads of Department and 48 Non-Staff Class Grade IV & V officers were promoted to Staff Class Grade I. In addition, 7 minor employees were promoted to Non Staff Class Grade I and 10 minor employees were promoted to Non-Staff Class Grade II.

### Employer – Employee Relations

A close dialogue between the trade unions and Bank management continued during the year. Through this the management was able to maintain the industrial harmony throughout the year and to achieve its objectives effectively.

### Performance Management System (PMS)

Performance appraisal for the year 2006 for all employees of the Bank was completed successfully during the year. Individual and departmental goal setting for the year 2007 was also carried out concurrently with the implementation of the strategic plan of the Bank.

### Manpower Planning

In 2007, 15 employees retired from the Bank service. In addition, 12 employees resigned from the Bank service for personal reasons. At the end of the year 558 staff officers, 481 non staff officers and 92 minor employees were in the service.

### Implementation of e-HR System

The web-based e-HR System introduced in late 2006 was implemented in 2007. Employee related data were entered into the e-HR System and the verification of this information is to be completed in 2008. Through the e-HR System, employees can view their employment related information while the management can take timely decisions on HR related matters quickly and efficiently. The e-HR System has enabled the HR Department to align itself with the bank's strategic plan.

### Strategic Management Forum

The HRD facilitated the organization of the strategic planning review workshop which was held with the participation of all stakeholders of the Bank. This forum provided an opportunity for all participants to discuss and agree on the departmental plan and the CBSL strategic plan for 2008 – 2012.

### Establishment of New Departments

Financial System Stability Department (FSSD) and Policy Review and Monitoring Department (PRM) were established at the beginning of the year 2007 to cater to the current requirements of the banking system.

### Meetings Attended by the Governor

1. To deliver the keynote address at the International Summit of Leading Global Turnaround Specialists held in India in January.
2. The panel discussion of the 2<sup>nd</sup> Asian Emerging Markets “New Frontiers” Conference held in Singapore in February.
3. To deliver an address at the inaugural session of the 9<sup>th</sup> South Asia Management Forum on Management for Peace, Prosperity and Posterity, in Bangladesh in February.
4. Meetings with Governor, Bank of England and Fitch Rating officials in UK in April.
5. The 36<sup>th</sup> Meeting of Board of Directors of the Asian Clearing Union held in Bangladesh in May.
6. Meetings with rating officials and international PR firms held in USA in June.
7. To deliver the keynote address at the 35<sup>th</sup> Annual Congress of the Fiji Institute of Accountants held in Fiji and to meet with the Deputy Governor of the Reserve Bank of New Zealand, in New Zealand in June.
8. The 42<sup>nd</sup> SEACEN Governors' Conference on “Living with Volatilities: Managing Exchange Rate and Capital Flows in Asia” and the 26<sup>th</sup> Meeting of the SEACEN Board of Governors held in Thailand in July.
9. Meetings with Joint Lead Managers with regard to the International Bond Issue in UK in September.
10. To deliver a special address at the panel discussion of the FICCI-IBA Conference on “Global Banking: Paradigm Shift” on Product Innovation, Efficient Delivery and Customer Value Management held in India in September.
11. The Roadshow with regard to Sovereign Bond Issue by the Sri Lankan Government, held in Singapore, Hong Kong, London, New York, Los Angeles and Boston, G-24, IMF and World Bank Annual Meetings and Development Committee Meeting 2007 and SAARCFINANCE Meeting held in Washington D.C., USA in October.
12. To meet the key Indian businessmen on the Sri Lankan Economy in New Delhi, India in October.
13. To hold a special meeting with the Iranian Government and the Central Bank of Iran in Iran in December.
14. To hold meetings in India, with industrialists, Businessmen, Chartered Accountants, Bankers and senior government officials of the State of Goa, India in December.

### APPOINTMENTS/PROMOTIONS

1. Mrs. M. Ramanathan, Attorney at Law and Justice of the Peace was appointed as a Member of the Monetary Board, effective from 06 December 2007.
2. The following promotions and designations were made effective from 03 December 2007.
  - a. Mr S. H. A. M. Abeyratne, Director of the Human Resources Department, was promoted to Staff Class Special Grade and designated as Assistant Governor.
  - b. Mrs. C. Premaratne, Superintendent and Registrar of the Public Debt Department was promoted to Staff Class Special Grade and designated as Assistant Governor.
  - c. Mr. P. Samarasiri, Director of the Bank Supervision Department was promoted to Staff Class Special Grade and designated as Assistant Governor.
3. Mrs. S. N. Perera was promoted and appointed as Acting Additional Superintendent of the Employees' Provident Fund Department effective from 01 January 2007.

4. Mrs. R. Dheerasinghe was promoted and appointed as Acting Additional Director of the Policy Review and Monitoring Department, effective from 01 January 2007.
5. Mr. B. D. W. A. Silva was promoted and appointed as Acting Additional Director of the Bank Supervision Department, effective from 01 January 2007 and as Acting Director of the Bank Supervision Department effective from 03 December 2007.
6. Mr. C. P. A. Karunatilake was promoted and appointed as Acting Additional Superintendent of the Currency Department, effective from 01 January 2007.
7. Mr. S. Lankatilake was promoted and appointed as Acting Additional Director of the Human Resources Department, effective from 01 January 2007 and as Acting Director of the Human Resources Department effective from 03 December 2007.
8. Mr. C. J. P. Siriwardena was promoted and appointed as Acting Additional Superintendent of the Public Debt Department, effective from 01 January 2007 and as Acting Superintendent and Registrar of the Public Debt Department effective from 03 December 2007.
9. Mr. R. A. A. Jayalath was promoted and appointed as Acting Additional Director of the International Operations Department, effective from 01 January 2007.
10. Mr. U. P. Alawattage was promoted and appointed as Acting Additional Controller of the Exchange Control Department, effective from 01 January 2007.
11. Dr. P. N. Weerasinghe was promoted and appointed as Acting Director of the Economic Research Department, effective from 01 January 2007.
12. Mr. S. S. Ratnayake was promoted and appointed as Acting Additional Director of the Department of Supervision of Non-Bank Financial Institutions effective from 01 January 2007 and as Acting Director of the Department of Supervision of Non-Bank Financial Institutions effective from 10 November 2007.
13. Mr. H. A. Karunaratne was promoted as Acting Additional Head of Department, effective from 01 January 2007 and appointed as Acting Additional Director of the Domestic Operations Department, effective from 29 January 2007. He was then appointed as Acting Additional Director of the Financial Intelligence Unit effective from 12 March 2007 and as Acting Director of the Financial Intelligence Unit effective from 01 June 2007.
14. Mr. N. J. Perera, Superintendent of the Employees' Provident Fund Department was appointed as Director of the Policy Review and Monitoring Department, effective from 01 January 2007.
15. Mr. L. Y. Dharmasena, the Director of the Welfare Department was appointed as Superintendent of the Employees' Provident Fund Department, effective from 1 January 2007.
16. Mr. S. Somapala, Additional Superintendent of the Employees' Provident Fund Department was appointed as Acting Director of the Statistics Department, effective from 01 January 2007 and as Director of the Statistics Department effective from 01 July 2007.
17. Mr. M. V. M. Fernando, Additional Director of the Welfare Department was appointed as Acting Director of the Welfare Department, effective from 01 January 2007 and as Director of the Welfare Department effective from 01 July 2007.
18. Miss. K. Saravanamuttu, Additional Director of the Communications Department was appointed as Acting Director of the Financial System Stability Department, effective from 01 January 2007 and as Director of the Financial System Stability Department effective from 01 July 2007.
19. Dr. W. M. Hemachandra, Acting Director of the Centre for Banking Studies was appointed as Director of the Centre for Banking Studies effective from 01 February 2007.
20. Mr. P. Samarasiri, Acting Director of the Bank Supervision Department was appointed as Director of the Bank Supervision Department effective from 14 February 2007.
21. Mr. A. Kamalasiri, Acting Director of the Domestic Operations Department was appointed as the Director of Domestic Operations Department effective from 15 May 2007.
22. Mrs. C. K. Nanayakkara, Director of the Communications Department was appointed as Secretary of the Secretariat Department effective from 18 May 2007.
23. Mr. M. M. Attanayake was appointed as Special Officer in-charge of the Policy Review and Monitoring Department effective from 12 September 2007 and as Director of the Policy Review and Monitoring Department effective from 17 December 2007.

24. Mr. S. J. A. Handagama, Staff Class Grade III officer, was appointed to act for Director of the Communications Department effective from 01 October 2007.
25. Mr. P. M. M. Pieris, President's Counsel, was appointed as Legal Consultant effective from 6 July 2007.

#### **RESIGNATIONS/RETIREMENTS**

1. The term of office of Mr. C. Chanmugam, appointed member of the Monetary Board, expired on 17 July 2007.
2. Dr. (Mrs.) Anila Dias Bandaranaike, Assistant Governor, retired from the Bank service effective from 02 October 2007.
3. Mr. George N. Fernando, Chief Executive Officer of the Financial Intelligence Unit, resigned from the position effective from 15 April 2007.
4. Mrs. L. K. Gunatilake, Director of the Department of Supervision of Non-Bank Financial Institutions, retired from the Bank service effective from 10 November 2007.
5. Mr. N. J. Perera, Director of the Policy Review and Monitoring Department, retired from the Bank service effective from 16 December 2007.

#### **OFFICERS ON RELEASE/LEAVE**

1. Mr. R. A. Jayatissa, Assistant Governor, to the Ministry of Finance and Planning as Senior Economic Policy Advisor and the Deputy Secretary to the Treasury.
2. Mr. K. G. D. D. Dheerasinghe, Assistant Governor, to the International Monetary Fund as an Alternate Executive Director.
3. Mrs. J. A. N. Dissanayake, Secretary to the Commission of Inquiry to Investigate into Matters Relating to Failed Finance Companies.
4. Mr. S. R. Attygalle, Staff Class Grade III officer, to the Ministry of Finance and Planning.
5. Mr. B. Lokuranamuka, Staff Class Grade II officer, to the Ministry of Finance and Planning.
6. Mr. H. P. M. Wasantha Kumara, Staff Class Grade I officer, to the Ministry of Finance and Planning.
7. Mr. M. Mahinda Saliya, Staff Class Grade I officer, to the Ministry of Finance and Planning.
8. Mrs. A. K. Hettiarachchi, Personal Secretary, to the International Monetary Fund.

9. Mrs. M. C. J. Fernando, Personal Secretary, to the Ministry of Finance and Planning.
10. Mrs. D. G. D. I. Ekanayake, Staff Class Grade I officer, to the Ministry of Finance and Planning.
11. Mr. E. W. K. J. B. Ehelapola, Staff Class Grade I officer, to the Ministry of Finance and Planning.
12. Mr. K. A. U. S. K. Thilakarathne, Staff Class Grade I officer, to the Ministry of Finance and Planning.
13. Mrs. H. M. N. S. Gunawardena, a legal officer on contract to the Legal and Judicial Reforms Project Phase II.
14. Mr. E. A. Hettiarachchi, Staff Class Grade IV officer on no pay leave.
15. Mrs. R. Dheerasinghe, Staff Class Grade IV officer on no pay leave.

#### **13. INFORMATION TECHNOLOGY**

Main focus of the Information Technology Department (ITD) during the year under review was to re-engineer the existing manual and semi-automated systems to web enabled applications adopting new technology with the aim of providing value added IT services. Accordingly, the first web application developed by ITD, the Central Database application was further extended to cover the user requirements of the

- Payments and Settlements Department for collection of information required for publishing the Payments Bulletin.
- Economic Research Department for collection of information on loans, advances and deposits of banks for quarterly survey analysis.
- Bank Supervision Department for implementing new capital adequacy framework under the Basel II.
- Domestic Operations Department for collecting weekly information on statutory reserve requirements of commercial banks.

In order to align the IT strategy with the overall business strategy of the Bank, ITD identified several applications to be brought into a single platform using a centralized concept. This integrated project concept, which was first implemented for the Central Database system, was extended to develop a software solution for Regional Development Department to handle Refinance and Credit Guarantee loan schemes. This project was implemented during 2007. The second phase of the project, the computerization of the New Comprehensive Rural Credit Scheme



(NCRCS) is in progress. Similarly, the requirements of Exchange Control Department were also considered under this integrated concept and two identified applications were prioritized under the first phase of this project. Accordingly,

- the existing Foreign Exchange Sales and Purchases application will be converted to a web application to provide wider coverage
- new web application for monitoring of foreign exchange transactions through Electronic Funds Transfer Cards will be developed.

The integrated application for Exchange Control Department is expected to be implemented as a secure, user-friendly application in mid 2008.

ITD provided support services for CBSL to achieve its core objectives, improve agency functions and further automate its corporate services for reduction of operations costs by implementing the following major IT systems during the year:

- i. Expansion of web based offsite surveillance reporting system
- ii. Implementation of the Linux based e-mail system
- iii. Implementation of countrywide data collection system
- iv. Expansion of Currency Department automation project
- v. Automation of Asian Clearing Union activities
- vi. Automatic file transfer facility for SWIFT message transfer
- vii. Web-based Reporting system for secondary market sales of government securities for primary dealers
- viii. Integrated system for maintaining domestic debt
- ix. Fallback system for trading government securities in a contingency event
- x. Redesigning of the computer application used for reporting daily money market rates by commercial banks through the wide area network
- xi. Implementation of a web application to handle Overnight Customer Repo transactions along with the auto reversal facility
- xii. Implementation of an incident reporting and handling system at the IT help desk to implement the recommendations made by the IT auditors

ITD continued its efforts of strengthening the IT infrastructure by improving the disaster recovery (DR) facilities at the backup site. Live day operations of all critical applications were conducted from the DR Site on three occasions with the participation of other commercial banks and primary dealers. A

separate Internet connection was provided to the DR Site from an alternate service provider as a contingency arrangement to be used in an emergency situation. The business continuity plan document was reviewed and updated incorporating the changes during the year.

ITD initiated a process of moving towards open source solutions wherever possible. As a means of further reduction of software licence costs, CBSL entered into a Business and Services Agreement with the Microsoft Corporation to obtain licensed software at a reduced price. CBSL Network was further strengthened by installing security appliances such as firewalls and Intrusion Detection/Prevention systems.

To facilitate the planned SWIFTNET phase II migration, SWIFT alliance software was installed in separate servers. To align with this change, the operating system and application software package used for LankaSettle and LanakSecure systems, CAS 3.3 was successfully upgraded to CAS 3.4 as prescribed by the vendor to ensure financial system stability through proper maintenance of the national payment system. ITD was also involved in evaluating the backup arrangements of other commercial banks and primary dealers.

ITD continued its efforts in providing technical assistance to projects of national interest. These include the setting up of the Lanka Financial Services Bureau, Common payment switch and evaluating proposals for implementation of a software solution for combating terrorist financing and anti-money laundering. In addition, ITD participated in many technical evaluation committees for procurement of IT related equipment for national projects such as the Inland Revenue computerization, Credit Information Bureau system, State Mortgage and Investment Bank system and several projects of rural banks.

The Department also engaged in continual update of ICT competencies among the CBSL staff as well as the staff of financial institutions by releasing officers to the CBSL training centre as resource persons and conducting internal training/awareness sessions for departmental liaison officers. In order to comply with the government language policy, user version of Information Security Policy was published in Tamil in addition to English and Sinhala.

ITD continued to maintain the Employees' Provident Fund system and was able to achieve almost 100 per cent system availability during the year. IT staff actively participated in conducting electronic media

contribution collection promotional workshops. ITD also provided necessary technical support for the EPF Re-registration project and currently is in the process of extending the support services to the members through web services.

## 14. INTERNATIONAL OPERATIONS

### 14.1 Foreign Exchange Reserve Management

The Monetary Law Act requires the Central Bank to maintain an adequate international reserve in liquid currencies and a nuclear reserve in gold in order to facilitate maintenance of external stability of the Sri Lanka rupee and to assure the greatest possible freedom of the country's international transactions. The responsibility of managing the official foreign exchange reserves of the country is entrusted with International Operations Department (IOD) in order to achieve the above objectives.

In 2007, the foreign exchange reserves composed of currencies such as US dollars, euros, sterling pounds, Australian dollars and gold while the reserves were invested mainly in two asset classes i.e., Fixed Income Securities (FIS) and money market instruments. Bank's FIS portfolio consisted of highly rated sovereign government securities, government guaranteed securities, and securities of government agencies and supranational institutions. In reserves management, special attention was paid to fulfill the liquidity requirements through maintenance of a sufficient proportion of reserves in highly liquid short-term instruments of both asset classes. All the transactions with respect to reserves management were performed only through approved counterparties adhering to the limit structure approved by the management and considering the safety, liquidity and return on such assets.

Reserves management operations in its entirety were carried out in accordance with the guidelines approved by the Monetary Board. The Foreign Reserve Management Committee (FRMC), as required by the Foreign Exchange Reserves Management Guidelines continuously supervised the overall operations of foreign exchange reserve management and provided necessary guidance as appropriate during the year. Periodic performance of reserve management was measured against the set benchmark which reflects the risk tolerance levels of the bank.

During the year 2007, particularly in the second half, the financial market turmoil sprung through the US sub-prime mortgage crisis resulted in a liquidity and credit crunch. High oil prices fluctuating from US \$

51 to US \$ 99 (the benchmark West Texas Intermediary Brand) and world food prices soaring leading to picking up of global headline inflation, posed new challenges and questions to both policy makers and investors. This created a continuously challenging environment for reserve management operations.

The Bank's reserves were substantially increased towards the latter part of 2007 mainly as a result of receiving the proceeds from the Sri Lanka's debut international Bond issue amounting to US \$ 500 million. With continuous reviewing of the market and economic fundamentals in selected currencies/countries and keeping in line with the risk appetite of the Bank, IOD made necessary changes to currency and asset composition of the international reserves from time to time. Liquidity requirements of the Bank, public debt repayments, risk management parameters and income generating abilities were the key issues considered in determining the asset and currency composition of the reserves portfolio.

The foreign exchange reserves of the Bank have grown from US\$ 2,323 million to US\$ 2,881 million during this period. During the year, reserve management operations have generated a net foreign exchange income of US\$ 125.3 million or Rs. 13,861.9 million exceeding the income of the previous year amounting to US\$ 100.5 million. The increase in the income is the combined outcome of both increase in the level of reserves and interest rates. In order to augment the income IOD strengthened its securities lending programs in 2007.

### 14.2 Risk Management

The risks associated with the foreign exchange reserves and their investments span into various risks, of which major categories include foreign exchange risk, interest rate risk, credit risk, liquidity risk and operational risk. The risk exposure of the foreign exchange reserves and their investments are monitored by the Middle Office of the IOD.

The risk of losing capital as a consequence of fluctuations in exchange rates or the foreign exchange risk is mainly managed through currency diversification. By appropriate adjustments of the duration of the portfolio, the exposure of the Bank's reserves portfolio to movements in the interest rate or the interest rate risk was managed. The credit risk is minimised using the standard criteria used by the Bank to assess the credit risk of its counterparties. The liquidity risk which is the risk of incurring capital losses in the event of forced liquidation is managed by establishing liquidity requirements. The

operational risk resulting from human error, flawed systems and inadequate procedures and controls were managed through a range of measures.

### 14.3 Monitoring the Domestic Foreign Exchange Market Developments

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

IOD's operations in the domestic foreign exchange market contributed towards avoiding high volatility in the exchange rate during 2007. The exchange rate remained at Rs. 108.72 per US dollar at the end of December 2007 recording only a 0.93 per cent depreciation against the US dollar during the year compared to 5.19 per cent depreciation in 2006. The exchange rate stability was supported by foreign currency inflows particularly through interventions, sovereign bond issuance and opening of government treasury bonds upto a maximum of 10 per cent of the stock for foreign investors.

The volume of inter-bank foreign exchange transactions which amounted to US dollars 10,792 million in 2006 decreased by 14 per cent to US dollars 9,275 million in 2007 and the absorption and supply of foreign exchange from and to the domestic market were US dollars 593 million and US dollars 716 million respectively.

The process of providing exchange rates of Sri Lanka Rupee against other foreign currencies to Government Departments, corporations and other parties continued during 2007 too.

**TABLE - I**  
**Inter – Bank Foreign Exchange Transactions**  
**Volume – 2007**

US \$ mn					
Month	Spot	Tom	Cash	Forward	Total
January	352.70	48.92	62.85	205.95	670.42
February	278.25	64.20	63.15	164.63	570.23
March	655.05	109.85	2.60	266.31	1,113.81
April	386.65	111.05	78.22	238.44	814.36
May	350.80	101.20	75.35	202.39	729.74
June	248.65	90.25	59.37	259.00	657.27
July	93.45	89.30	61.35	111.01	355.11
August	147.92	75.00	68.80	182.14	473.86
September	206.25	107.97	48.92	193.66	556.80
October	586.45	171.77	64.55	332.64	1,155.41
November	468.62	99.32	107.42	336.39	1,011.75
December	581.45	147.30	105.90	331.81	1,166.46
	<b>4,356.24</b>	<b>1,216.13</b>	<b>878.48</b>	<b>2,824.37</b>	<b>9,275.22</b>

**TABLE - II**  
**Monthly Summary of CBSL Absorption and Supply**  
**of Foreign Exchange -2007**

US \$ mn			
Month	Absorption	Supply	Net
January	60.50	8.00	52.50
February	15.00	-	15.00
March	112.50	83.00	29.50
April	97.00	33.55	63.45
May	18.50	69.15	(50.65)
June	34.00	63.90	(29.90)
July	4.00	65.70	(61.70)
August	-	105.60	(105.60)
September	24.78	48.60	(23.82)
October	131.20	77.00	54.20
November	46.65	121.90	(75.25)
December	48.50	39.45	9.05
	<b>592.63</b>	<b>715.85</b>	<b>(123.22)</b>

## 15. LEGAL

During the year under review, the Legal Department worked towards facilitating the creation of an appropriate legal framework within which the Central Bank could achieve its objectives optimally. It also facilitated functions of the Central Bank within such framework.

Accordingly, the Department continued its services in advising the Bank on legal matters, representing the Bank in courts and other legal fora and contributing to the legal reforms in the banking and financial sector.

In 2007, amendments to several laws were pursued by the Department. It also played an active role in preparing rules, regulations and other legal documents under several statutes applicable to the sector. In particular, the Legal Department was involved in preparing subsidiary legislation under the Banking Act, Payment and settlement Systems Act and the Payment Devices Frauds Act.

## 16. MANAGEMENT AUDIT

The Department of Management Audit carried out its internal audit and management services functions in 2007 to facilitate the Bank to achieve its strategic objectives by making recommendations to improve the Bank's operations and systems of controls. The main focus was on risk based audit approach. The Department also served as the secretariat to the Audit Committee of the Monetary Board and the Bank-wide Risk Management Committee of the Bank.

In accordance with the Audit Plan 2007, several audit assignments were conducted to review the adequacy of the internal controls that are in place to protect the Bank from potential risks, while continuing with compliance audits to verify that the established

controls are functioning as intended. As in the previous year, follow-up audit reviews were also carried out to ascertain the implementation of audit recommendations.

During the year, more attention was given to process audits and the Department reported significant issues related to processes and also periodic information on the status and results of the Audit Plan.

The Management Audit Department carried out several management evaluation studies beyond the Audit Plan during 2007 with the objective of improving efficiency, economy and effectiveness of Bank's operations. The major management evaluation studies were study on performance of reserve management operations of International Operations Department, fixed asset verification and ownership, distribution of office space within the Bank, categorization and quantification of deficiencies in the Leave records, refurbishment of the building at Centre for Banking Studies and a survey on vintage notes and coins in the currency vaults. In addition, the normal internal audit work relating to ordinary operations of the Bank was also completed during the year.

During 2007, the Department continued to improve the bank-wide risk management system. Information was gathered on involvement of other departments in the risk management process through a risk management questionnaire and arranged awareness programs to enhance the knowledge of the Risk Officers (ROs). As an infrastructure development, further improvements were made to the Risk Register based on the suggestions made by the ROs.

Moreover, to develop a risk reporting system, a manual risk incident reporting system was introduced. In addition, Risk tolerance levels pertaining to the departmental activities and relevant risk management actions to be taken also were defined.

During the year, for further strengthening Bank-wide risk identification and reporting, the Department assisted the Risk Management Committee to appoint a Bank-wide Risk Officer who will identify, assess and report on the risks emanating from external sources to the bank (both domestic and international). The Department also assisted the Risk Management Committee to appoint a sub-committee consisting of Assistant Governors to review the bank-wide risk profile and to draft the format to report the changes in the risk profile of the bank periodically to the Risk Management Committee.

In addition to the above, the Department acted as an observer of the Foreign Reserve Management Committee and the Business Continuity Plan committee and as a member of the Board of Survey.

The Bank continued to make arrangements for the US based Institute of Internal Auditors (IIA) to conduct its examinations in Sri Lanka, mainly to build and maintain professionalism in internal and management audit. The Department has been actively collaborating with the Sri Lanka Chapter of IIA to promote its courses and the Central Bank is accordingly represented for the third successful year on its Governing Council.

## 17. PAYMENTS AND SETTLEMENTS

The Payments and Settlements Department (PSD) continued to carry out the functions relating to: operating the Real Time Gross Settlement (RTGS) System which is the systemically important large value payment and settlement system; operating the payment gateway for the Central Bank transactions that are effected through the RTGS System, back office operations to process and effect payment and settlement instructions in respect of Central Bank's foreign exchange reserve management and Open Market Operations (OMO); effecting SWIFT transactions of the Central Bank; handling Sri Lanka's transactions through the Asian Clearing Union (ACU); and policy formulation and oversight activities with regard to the payment and settlement systems in the country.

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

The RTGS Operations Division of the PSD continued its operations of the RTGS System and provided help desk services to participants during the year 2007. The Division focused more on maintaining a significantly high and consistent level of resilience of the RTGS System. The RTGS System operated smoothly in 2007 and the system availability improved to 99.7 per cent, when compared with 99.6 in 2006. The total volume of transactions settled through the RTGS system during the year increased by 11 per cent to 194,619, while the total value of transaction increased by 17 per cent to Rs.21, 266 billion. In 2007, the RTGS System recorded its ever-highest volume (1,217 transactions) and the value (Rs. 224 bn.) in a day. The daily average volume and value of transactions in 2007 was 801 and Rs. 88 billion respectively.

In line with the changes of the SWIFT infrastructure, during 2007, the RTGS System was upgraded into



'CAS 3.40' version. Accordingly the Access database used by the RTGS System was also changed into 'Windows 2003 Version.'

At the end of December, 2007 there were 34 participants in RTGS System which included the Central Bank, 23 LCBs, 8 non-bank Primary Dealer (PD) companies, Employees' Provident Fund (EPF) and the Central Depository Systems (Pvt) Ltd. (CDS) of the Colombo Stock Exchange.

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

The Forex, Gold and Foreign Securities Settlement Division of the PSD carried out back office operations via Treasury Dealing Room Management System (TDRMS) for transactions done by the International Operations Department (IOD).

The Division effected 7,320 settlement instructions and resolved settlement problems. During the year 2007, the Division was also involved in updating the back office module of the TDRMS.

### 17.3 Settlement of Transactions under Open Market Operations

The OMO Settlement Division of the PSD continued the settlement of OMO transactions done by LankaSettle participants with the Central Bank during 2007. The Division effected 3,260 repo transactions worth of Rs. 1,234 billion, 235 Reverse-repo transactions worth of Rs.172 billion, 630 outright sales worth of Rs.116 billion. The Division also continued the monitoring of the settlement of Intraday Liquidity Facility (ILF) obtained by the LankaSettle participants.

### 17.4 SWIFT Communications

In 2007, the SWIFT Communication Division of the PSD continued to handle activities relating to incoming and outgoing SWIFT messages of the Central Bank. During the period under review, the total number of messages received by the Central Bank increased by 22 per cent. Out of the total number of messages received, 15 per cent was related to Central Bank's own transactions. The balance was relating to LankaSettle transactions. The total number of messages sent by the Central Bank increased by 20 per cent.

The Division supported the following modifications of the SWIFT infrastructure of the Central Bank carried out by the Information Technology Department:

- installing of SWIFT Alliance Access Version 6.0.0;

- updating SAA/SAE/RMA patch version 6.0.30;
- migrating from Bilateral Key Exchange (BKE) to Public Key Infrastructure (PKI); and
- applying the Relationship Management Application (RMA) for the Central Bank's test and training modes under the SWIFTNet Phase 2 migration.

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

The total value of transactions of Sri Lanka effected through the ACU Mechanism increased by 25.8 per cent from Rs.268 billion in 2006 to Rs.337 billion in 2007. This was mainly due to increased oil imports from India and Iran.

The rupee value of net settlements made under the ACU mechanism during 2007 increased by 24.4 per cent and amounted Rs.293.5 billion in 2007.

**Table**  
**Trade and ACU transactions of Sri Lanka**  
**with other ACU countries** Rs.billion

	2006	2007
Total transactions channelled through ACU	267.9	337.1
Sri Lanka's exports to other ACU countries	67.9	78.7
Sri Lanka's imports from other ACU countries	321.2	403.7
Sri Lanka's total trade with other ACU countries	389.1	482.4
Net ACU settlement	235.9	293.5

Source: Central Bank of Sri Lanka

The 36<sup>th</sup> Meeting of the Board of Directors of the Asian Clearing Union was held in Dhaka in May 2007. A decision was taken at this meeting to appoint a technical committee comprising representatives from all member countries to examine: (a) the possibility of multi-currency settlement option for ACU transactions; and (b) propose an incentive package that can be offered to encourage commercial banks in member countries to pay an interest on accounts maintained with them by the commercial banks of other member countries in order to maintain sufficient balances in ACU accounts. The ACU Technical Committee meeting was held at the Central Bank of Sri Lanka, on July 05, 2007 and decided on the following course of action:

- discuss the recommendations made by the Technical Committee with the stakeholders. i.e., (banks/exporters/importers/chambers of commerce) in the respective ACU member countries;



- (b) initiate discussions at their respective Central Banks on issues relating to deferred net settlement of clearing balances under the ACU mechanism from the monetary policy and supervisory perspectives as well as operational risk mitigation point of view;
- (c) report feedback to the Technical Committee at a future meeting and modify recommendations if necessary; and
- (d) report the agreed recommendations to the Board of Directors of the ACU.

In pursuance of above decisions the Central Bank of Sri Lanka formulated 3 sets of questionnaires to be circulated among all stakeholders (exporters/importers, commercial banks and the relevant internal parties of the Central Banks) of the ACU member countries. The ACU Division of the Central Bank of Sri Lanka circulated the questionnaires among stakeholders and obtained the responses from each category of stakeholders. The Central Bank of Sri Lanka circulated these responses among all committee members of the Technical Committee in order to facilitate the formulation of new policy stance at the next ACU Technical Committee meeting scheduled to be held in India in 2008.

### 17.6 Payment System Policy and Oversight

In line with the strategic plan of the Central Bank, during 2007 the Policy and Oversight Division of the PSD paid much attention on strengthening the payment and settlement system oversight framework of the Central Bank by :

- strengthening further the operational robustness of the LankaSettle System, the systemically important payment and settlement system (PSS);
- promoting further the migration from predominantly cash or paper based retail payments to electronic payments;
- encouraging banks as well as their customers to use relatively low risk payment means and systems; and
- pursuing the banks to pass the cost saving and efficiency benefits of PSS to the customers.

Having considered the possibility for an operational failure of a participant to create risks to the LankaSettle System, oversight activities were directed to assess the preparedness of each participant for continuing critical operations such as payment and core banking in a disruption. During 2007, the Policy and Oversight Division evaluated the business continuity plans (BCPs) of LankaSettle participants and directed them to improve their BCPs where

necessary. In September 2007, the Division commenced on site inspections of disaster recovery (DR) sites of LankaSettle participants, with the assistance of the officers from the Bank Supervision Department and the Information Technology Department of the Central Bank.

In view of ensuring proper functioning of the Cheque Imaging and Truncation (CIT) System, the Policy and Oversight Division advised and assisted LankaClear to issue a clear and comprehensive set of CIT System Rules and an Operational Manual.

Having considered the public policy objective of facilitating the customers to receive cheque proceeds within T+1 (where T is the day of receiving the cheques for clearing at LankaClear and 1 is the following business day) under the Cheque Imaging and Truncation (CIT) System, the PSD was involved in drafting and issuing a Direction to the participating banks of the CIT System in November 2007, to ensure that banks credit proceeds of cleared cheques to their customers' accounts on T+1.

Further the Policy and Oversight Division devoted more time to facilitate the implementation of the action points of the Road Map (2007-2010) which is aimed at fostering the development of the payment and settlement infrastructure of the country.

To facilitate the implementation of the Road Map the Division performed the following functions in 2007:

- extended fullest cooperation to establish the Lanka Financial Services Bureau Ltd. (LFSB), a local SWIFT Service Bureau by banks to provide a more economical and safe common connectivity point at the primary and disaster recovery (DR) sites of LankaSettle participants to communicate with SWIFTNet, the communication infrastructure of the LankaSettle System;
- the need to regulate the fast changing money, payment, clearing and settlement service providers and the lack of clarity in the Payment and Settlement Systems Act No. 28 of 2005 (PSSA) regarding the powers of the Central Bank in this area were brought to the attention of the Minister of Finance and Planning and accordingly the H.E. the President issued the Money, Payment, Clearing and Settlement Service Providers Regulations No. 01 of 2007 under the powers vested on the Minister by the PSSA. The regulations were published in the Government Gazette No. 1503/11 on June 27, 2007; and

- In the exercise of the powers conferred to the Central Bank by these regulations, the Policy and Oversight Division has drafted a Direction on Service Providers of Card Based Payment Instruments to set out the minimum prudential requirements on all Service Providers in Sri Lanka to enhance the level of security of cards and the systems in which the card based transactions are processed, cleared and settled. This Direction will be issued to the public in early 2008.

Having considered the increased interest of SAARC member countries to reform their national PSS and growing recognition of the benefits of a collective regional effort to foster PSS developments in the SAARC region, the PSD made arrangements to host the SAARCFINANCE Conference on Regional Payments Initiative in July 2007. This conference is a milestone in the PSS development in the SAARC region as the Governors of the SAARCFINANCE Group approved the proposal of creating a SAARC Payments Initiative. In 2008 the Central Bank will take the lead of forming the SAARC Payments Initiative by chairing the SAARC Payments Council and establishing its Secretariat in the Central Bank.

## 18. POLICY REVIEW AND MONITORING

The Policy Review and Monitoring Department (PRMD) was established on 1<sup>st</sup> January 2007. The objectives of the Policy Review & Monitoring Department are twofold: to review and assess the impact of policies implemented by the Bank with a view to improving their effectiveness; and to monitor and review the progress of the Strategic Plan of the Central Bank with a view to ensuring its implementation within the time lines and in accordance with the qualitative expectations of the management.

The Bank formulated a medium term Strategic Plan for 2007 – 2011. It identified the strategies which the Bank intends to follow in its key business areas on the basis of strategic objectives. Goals have been set with time frames and targets in each of the areas to enable the measurement of performance. The progress of the plan is monitored and reviewed by the PRMD, particularly through periodic reports and meetings with each Head of the department, which are chaired by the Assistant Governor in charge of Policy Review and Monitoring. The progress is in turn reported to the Strategic Plan Review Committee comprising the Corporate Management of the Bank, chaired by the Governor. In 2007 two rounds of such meetings were held. These meetings proved to be

effective in ensuring the implementation of the plan, particularly by identifying deviations and directing progress towards the desired path.

The progress of the plan during its first year of implementation was reviewed at a retreat involving the senior management of the Bank in November 2007. With appropriate modifications made, the plan was rolled over till 2012 and the new strategic plan 2008 – 2012 was designed.

In terms of policy reviews, the department has completed the following policy papers:

- (i) The Margin Deposit Requirement against LCs in respect of selected consumer products and motor vehicles;
- (ii) Vault cash requirement of SRR;
- (iii) Pre-feasibility study on the establishment of a futures market and commodity exchange for agricultural produce in Sri Lanka.

In addition, the department also completed a study on the cost of supervision of banking institutions.

## 19. PREMISES DEPARTMENT

The Premises Department continued to carry out the maintenance and upkeep of the Bank's Premises during the year 2007, in addition to providing support services such as transport and communication facilities to officers of the Bank.

Most of the maintenance work and a part of the transport services have been outsourced with a view to obtaining services more efficiently and at lowest cost.

While the construction of the Hostel Block was in progress there was change in scope of work of this construction as the Bank wanted to enhance the facilities in all the 66 participant rooms, provide air-conditioning, hot water system, telephone system etc. to a 3 star rating level and it was re-named as "Sovereign Residences". The project is expected to be completed by end of March 2008, opening the possibilities for training programs to be offered for the first time at CBS along with residential facilities.

Due to the widening of the Anagarika Dharmapala Mawatha a part of the regional office at Matara had to be demolished and with the demolition it was decided to refurbish the entire regional office building at a cost of Rs.30 million. The construction work has already started.

The development of Transwork Square in Colombo Fort was initiated during the year 2007 where the Bank currently holds the leasehold right for a block

land of 134 perches obtained from the Urban Development Authority for a multi-storey car park. CBSL will get free parking facilities of 400 cars and 10 buses and office space of 10,000 sq. ft. in lieu of the land.

The Department continued to maintain the Light House Clock Tower with a historic landmark value adjacent to the Bank's Head office.

## 20. PUBLIC DEBT DEPARTMENT

Public Debt Department (PDD) recorded significant achievements during 2007, in carrying out its responsibilities relating to issuing and managing public debt on behalf of the Government as its agent. Keeping in line with the strategic plan of the Central Bank, PDD formulated a medium term debt management strategy in 2007. This debt management strategy contains the medium term strategies to (a) ease the long standing bunching of debt maturities, (b) lower the fragmentation in the bond market, (c) introduce benchmark bond series and develop a benchmark yield curve, (d) develop a credible and liquid debt market, (e) introduce diversified debt instruments, (f) broaden the investor base, and (g) restructure the primary dealer system.

The maturity structure of outstanding domestic debt shows that there is a considerable bunching of debt maturities towards the shorter end of the maturity profile. In order to address this bunching problem, a debt consolidation programme has been designed and a test run to assess its effectivity was conducted during the year. As in the previous year, PDD took measures to address high fragmentation in the bond market as well. It continued the policy of reopening the existing Treasury bond series, while limiting the introduction of the new bond series to the market. As a result, the total number of Treasury bond series reduced to 42 at end 2007 from 53 at end 2006. Recognizing the importance of strengthening the Primary Dealer (PD) system, PDD took steps in 2007 to restructure the PD system in order to diversify their activities.

Another landmark achievement during 2007 was the successful launching of the first international sovereign bond issue. This was issued in a benchmark size of US dollar 500 million with an 8.25 per cent coupon rate and a five year maturity. This debut international sovereign bond issue was an absolute success and was oversubscribed by more than three times. With a view to lower the pressure on the interest rates in the domestic market, and to broaden the investor base of government securities market, the maximum limit of rupee denominated Treasury bonds available for foreigners was also increased to

10 per cent of the outstanding bond stock in November 2007 from the initially allowed maximum limit of 5 per cent in 2006. The entry barriers for foreign investors such as minimum holding period of one year, restrictions on maturity period and use of bonds for Repo transactions were also removed in early part of 2007. Issuing of Sri Lanka Nation Building Bonds, which was introduced in the previous year for a period of one year, was terminated in February 2007.

In order to reduce the transaction cost of participating banks and PDs, associated with the recording of government securities, PDD introduced a CBSL Wide Area Network based application for the market participants to record small value transactions. This enhanced safety of small investors in the government securities market by recording of all transactions in the Central Depository System (CDS) maintained at the CBSL. In line with this, the system rules of the LankaSecure system were also amended to impose a penalty to those who do not comply with this mandatory recording requirement.

With a view to expanding the investor base of government securities, PDD conducted a rigorous investor awareness programme coupled with a newspaper advertising campaign during the year. In line with the awareness campaign, PDD took steps to introduce retail outlets at regional level to trade government securities to the retail customers in collaboration with the NSB Fund Management Company Limited and the LankaClear (Pvt) Ltd. Thirteen such outlets were opened island-wide on 1<sup>st</sup> August 2007. In 2007, PDD published its first annual publication on public debt management with the purpose of disseminating information to the general public on the level and management of public debt. In addition, it would help to maintain a high level of transparency in the public debt management process. To enhance the knowledge of policy makers, academics and players in the government securities market, a capacity building workshop was organized by PDD in collaboration with the United Nations Economic and Social Commission for Asia and the Pacific (UN-ESCAP).

PDD also facilitated two missions; Fitch Ratings and Standard and Poor's (S&P) on the country's sovereign rating review during the first quarter of the year.

### 20.1 Developments in 2007

#### Borrowing Targets and Strategy

The gross borrowing limit approved by the parliament for 2007 under the Appropriation Act No.47 of 2006 was Rs. 655 billion. It was estimated to raise Rs. 433

billion from domestic sources and Rs. 202 billion through foreign sources. Another Rs. 20 billion was set aside for contingencies. During 2007, PDD mobilized a sum of Rs. 411 billion through domestic sources and Rs. 199.7 billion through foreign sources in terms of book value and maintained total borrowings within the original borrowing target. However, due to the high yield rates that prevailed in the domestic market, in line with the rising inflation and tight monetary policy stance, PDD had to deviate to a certain extent from its initial domestic borrowing plan, relying more on short-term debt instruments, non-marketable instruments, foreign currency denominated debt instruments and foreign investments on Treasury bonds. Thus, Rs. 23.3 billion was raised as rupee loans and Rs. 37 billion was raised as Treasury bills as against the original borrowing targets of Rs. 10 billion and Rs. 5 billion respectively. In addition, borrowings through SLDBs amounted to Rs. 23.6 billion in comparison to the original target of Rs. 10.5 billion. In contrast, the borrowings through Treasury bonds were low, with a value of Rs. 302 billion as against the original target of Rs. 356 billion (in book value terms). However, out of these Treasury bonds 61 per cent falls in to maturities above 3 years, showing the appetite of foreign investors to invest in longer term bonds due to attractive rates. Total foreign investment in Treasury bonds amounted to Rs. 49.7 billion, of which 54 per cent was over 3 year maturity.

To ease the pressure on the domestic rupee market, more reliance was placed on foreign currency borrowings during 2007. The project/programme loans expected during the year amounted to Rs. 156 billion. However, only Rs. 91.8 billion worth of loans had been realized by the end of the year. In contrast, the commercial loans far exceeded the original target of Rs. 46 billion and stood at Rs. 116.3 billion during 2007. This included the international sovereign bond issue of Rs. 56 billion, Treasury bonds issued to foreigners worth Rs. 36.8 billion and a syndicated loan of Rs. 23 billion arranged through the Bank of Ceylon. In addition, Rs. 35.7 billion was raised by issuing Sri Lanka Development Bonds (Rs. 23.6 billion) and FCBUs borrowings (Rs. 12.1 billion).

## 20.2 Issuance of Debt Instruments

In 2007, PDD conducted 52 Treasury bill auctions and issued a sum of Rs. 817.2 billion (face value terms) in gross terms. Reflecting the strong market preference towards the short term bills, 67 per cent of the total gross issues were for maturities of less than or equal to 91 day Treasury bills. As a result, 54 per cent of outstanding Treasury bills as at end 2007 had remaining maturity of 3 months or lower. The

PDD was able to raise Rs. 401 billion (face value terms) through Treasury bond programme by conducting 70 auctions as well as through private placements. This includes foreign investments amounting to Rs. 52.1 billion. In addition, Rs. 23 billion of Rupee Loans were also issued.

Sri Lanka Development Bonds (SLDBs) with a maturity of two years were issued through competitive bidding process during the year. The auction was oversubscribed by more than four times with bids amounting to US Dollar 215.25 million and the bids received were accepted at a rate of six month LIBOR plus a margin of 155.24 basis points.

In addition, a foreign commercial borrowing through a syndicated loan amounting to US Dollar 210 million with a tenure of 3 years was obtained at the rate of three month LIBOR plus a margin of 155 basis points. This loan was arranged by the Bank of Ceylon.

## 20.3 Debt Service Payments

In 2007, PDD serviced Rs. 482 billion of foreign and domestic loans. This includes Rs. 176 billion of interest payments and Rs. 306 billion of amortization payments. Total debt service payment on the

**Issue and Maturity of Domestic Debt in 2007** *Rs. mn.*

	Maturity	Issues	Repayments	Net Issues
Treasury Bills	91 day	358,882	354,834	4,048
	182 day	75,716	52,165	23,551
	364 day	97,810	74,454	23,356
	Other	284,780	286,455	(1,675)
	Total	817,188	767,908	49,280
T Bonds	1 year	41,884	15,957	25,927
	2 year	75,614	64,531	11,083
	3 year	37,436	55,900	(18,464)
	4 year	39,623	37,100	2,523
	5 year	88,909	45,170	43,739
	6 year	85,937	-	85,937
	7 year	17,105	-	17,105
	11 year	14,677	-	14,677
	Total	401,185	218,658	182,527
R Loans	2 year	4,461	-	4,461
	3/4 year	1	-	1
	3/6 year	6	-	6
	4/6 year	2	-	2
	3/7 year	2	-	2
	7/8 year	-	8,500	(8,500)
	3/10 year	18,824	-	18,824
	Total	23,296	8,500	14,796
Sri Lanka Dev. Bonds	2 year	23,592	-	23,592
	Total	23,592	-	23,592
Loans from FCBUs	1 year	11,637	11,077	560
	2 year	443	-	443
	3 year	-	3,401	(3,401)
	Total	12,081	14,478	(2,398)
<b>Total</b>		<b>1,277,341</b>	<b>1,009,544</b>	<b>267,797</b>

Source : Central Bank of Sri Lanka



domestic debt amounted to Rs. 390 billion while total foreign debt service payments amounted to Rs. 92 billion.

## 20.4 Yield Rates and Secondary Market Performance

The rising trend in the yield rates of government securities, that was observed in the recent past, continued during 2007. High inflation, inflationary expectations and tight liquidity situation driven by tight monetary policies and the heavy government borrowing programme could be cited as major contributing factors to this increasing trend in the yield rates in the rupee market. Treasury bill yield rates for 91, 182 and 364 day maturities increased by 737, 720 and 697 bps, respectively, between January to December 2007. The yield rates for Treasury bonds with maturities of 2-3yrs rose by 422 bps during the same period. In line with the upward movement of the interest rate structure in the primary market, the yield curve of the secondary market too was gradually shifted upward during the year.

In the secondary market, Treasury bill transactions had markedly improved in 2007 showing the strong market preference that prevailed for short-term maturities. Treasury bill transactions in the outright market had increased by 66 per cent, while in the repo market, the Treasury bill transactions had increased by 102 per cent. Treasury bond outright transactions too had increased in the secondary market by 30 per cent mainly due to the higher participation of foreign investors. However, Treasury bond transactions in the repo market had declined by 10 per cent as market participants use their increased Treasury bill holdings for repo transactions.

## 20.5 Scripless Securities Settlement System (SSSS) and the Central Depository System (CDS)– Lanka Secure

PDD continued the LankaSecure operations in 2007 with its participants, including 23 Licensed Commercial Banks (LCBs), 8 non-bank primary dealers, Employees' Provident Fund and Central Depository Systems (Pvt.) Ltd of the Colombo Stock Exchange (the CDS Ltd.). In 2007, the total number of transactions taken place through SSSS increased by 60 per cent to 295,470 from 184,476 in 2006 while the value of transactions increased by 57 per cent to Rs. 17,964,103 million. Total number of registered investor accounts maintained at the CDS has also shown noticeable increase by 56 per cent to 41,953 from 26,936 in 2006. These developments have taken place mainly due to the aggressive awareness campaign, opening of new government securities retail outlets, introduction of CBSL Wide Area

Network based application to record small value repositioning transactions free of charge and several other directions issued by PDD.

## 20.6 Primary Dealer Supervision

The supervision of Primary Dealer (PD) activities was continued through off-site surveillance and on-site examinations. In 2007, PDD carried out six regular on-site examinations and continuously engaged in off-site surveillance activities by reviewing financial statements and monitoring PD performance in primary and secondary markets.

## 21. REGIONAL DEVELOPMENT

In 2007, the RDD continued its activities aimed at improving the access to finance by the agriculture, small and medium and micro enterprise sectors by formulating and executing sustainable cost effective credit delivery and credit supplementation programmes. Negotiations were concluded in respect of a comprehensive new donor funded poverty alleviation scheme which will commence in 2008. Further, in the microfinance sector the Poverty Alleviation Microfinance Programme (PAMP) Revolving Fund Scheme, which was set up to utilize loan recoveries of PAMP and came into operation in 2007, was designed to maximize outreach and resources to beneficiaries. In 2007, RDD explored the possibility of establishing a Commodity Exchange to facilitate price risk management and derive further benefits for the agriculture sector. Further, consequent to the liberation of the Eastern Province, RDD participated in the committee appointed to design and implement a three year development plan for the Province. It also continued to advise the Government on regional development issues and in particular its recommendation for the introduction of a concessionary credit scheme for agro and dairy processing activities was included in the Budget for 2008. The Regional Offices of the Central Bank which operate several development programmes under the RDD, continued to play a major role in coordinating credit delivery activities, promoting Forward Sales Contracts (FSC) and disseminating information in the regions.

During 2007, the RDD implemented/coordinated the undermentioned loan schemes in respect of which either refinance was provided or interest subsidy was paid to Participating Financial Institutions (PFIs).

### 21.1 Refinance Schemes

#### (a) Agricultural Sector

Second Perennial Crops Development Project  
Revolving Fund Loan Scheme - SPCDPRF



Tea Development Project Revolving Fund Loan Scheme - TDPRF

**(b) Small and Medium Enterprise Sector**

Matale Regional Economic Advancement Project - MREAP

Sabaragamuwa Province Integrated Rural Development Project - SPIRDP

**(c) Micro Finance Sector**

Small Farmers and the Landless Credit Project Revolving Fund Scheme - SFLCPRFS

Poverty Alleviation Micro Finance Project Revolving Fund Scheme - PAMPRFS

Dry Zone Livelihood Partnership Programme

**21.2 Interest Subsidy Schemes**

**(a) Agriculture Sector**

New Comprehensive Rural Credit Scheme (NCRCS)

Krushi Navodaya Scheme (Implemented by Lankaputra Bank with CBSL coordinating interest subsidy payments)

Details of the above loan schemes are summarized in Table 1.

Project and Implementation Period	Source of Funds	Broad Mission	Fund Allocation	Annual Interest Rate to Borrowers	Recovery Rate where applicable
<b>1 Agricultural Sector</b>					
1.1 Second Perennial Crops Development Project (SPCDPRF) 2006-2014	GOSL	Commercialization of Perennial Crop Sector, increasing production, nursery development, post-harvest handling and processing activities and marketing.	Rs.1.2 bn.	9%	Around 90%
1.2 Tea Development Project (Revolving Fund) - (TDPRF)- 2006-2018	GOSL	Increasing tea small holders' income on a sustainable basis and developing the necessary infrastructure required for meeting the requirements of the export market. In this connection, assistance is available basically to modernize tea factories to acquire HACCP certification.	Rs.1.1 bn.	9%	Around 90%
1.3 New Comprehensive Rural Credit Scheme - (NCRCS) (Continuous Programme)	PFI's own funds and Govt. Interest Subsidy	Provision of the working capital requirement of small farmers <ul style="list-style-type: none"> <li>• Short-term production loans</li> <li>• Production of seeds and plant material</li> <li>• Purchase of agricultural commodities under Forward Sales Contracts.</li> </ul>	Loans granted by PFI's using their own funds	8%	Over 90%
1.4 Krushi Navodaya Scheme(March 2007- end February 2010)	PFI's own funds and Govt. Interest Subsidy	Provision of medium term loans for activities in agriculture and animal husbandry including agro related industry and micro and drip irrigation.	Loans granted by PFI's using their own funds- Total fund delivery during operational period expected to be Rs.3000 mn.	8%	
<b>2 Small and Medium Enterprises Sector</b>					
2.1 Matale Regional Economic Advancement Project (Revolving Fund) - (MREAPRFS) (2007-2009)	IFAD	Raising the income of rural and farm families by providing funds for small and medium scale enterprises in the District.	Rs.77mn allocated for 2007. Further allocation for 2008 being awaited	10%	Borrowers enjoying grace period
2.2 Sabaragamuwa Province Integrated Rural Development Project (Revolving Fund) - (SPIRDPFRF) (2007-2010)	GOSL	Upliftment of the living conditions of the people in the project area by promoting income-generating activities.	Rs.100 mn.	10%	Borrowers enjoying grace period

Project and Implementation	Source of Funds	Broad Mission	Fund Allocation	Annual Interest Rate to Borrowers	Recovery Rate where applicable
2.3 Post-Tsunami Line of Credit – EIB Contract B Loan Scheme (2006-2014)	EIB	To assist the affected medium and large scale enterprises in the Tsunami affected districts.	EURO 20 mn.	9%	Grace period
2.4 Construction Sector Development Project (2007-2015)	AFD	Financing the purchase of machinery by companies rated by the Institute of Construction, Trade and Development for post-tsunami reconstruction activities.	EURO10 mn.	9%	
<b>3. Micro Finance Sector</b>					
3.1 Dry Zone Livelihood Support and Partnership Programme (2006-2012)	IFAD	Poverty alleviation and income generation among the poor farmers in the selected districts i.e. Monaragala, Kurunegala, Badulla and Anuradhapura.	SLR200 mn.	10%	
3.2 Small Holder Plantation Entrepreneurship Development Programme (2007-2015)	IFAD and USAID	Improving the livelihoods of marginalized small holders who are producing tea and other perennial crops in the mid-country region and poor upland food crop farmers in the intermediate zone of Moneragala region wishing to take up rubber cultivation.	USD 40.7 mn.	9%	Over 90%
3.3 Small Farmers & Landless Credit Project Revolving Fund	GOSL	Setting up of an effective credit delivery mechanism for channelling formal credit to income generating activities for the rural poor to improve the economic conditions and general welfare of the beneficiaries.	SLR512.7 mn.	16%-20%	
3.4 Poverty Alleviation Micro-finance Project (Revolving Fund) Scheme	GOSL	Setting up of an effective credit delivery mechanism for channeling formal credit to income generating activities for the rural poor to improve the economic conditions and general welfare of the beneficiaries. Poverty eradication of identified borrowers through promotion of income generating activities among them. Organizing low-income groups to link with the formal banking system.	SLR 1250 mn.	16%	

### Agriculture Sector

During 2007, on the recommendation of the RDD, the Ministry of Finance and Planning agreed to extend the crop coverage of the NCRCS scheme. Accordingly, interest subsidy will be payable to PFIs under the NCRCS for loans provided for the cultivation of pineapple, sugar cane, betel, ginger, orchids and anthuriums (for export), and for production of bees honey and seed paddy. The total number of crops/products covered under NCRCS is now 37. Under this scheme, loans to the value of Rs.967 mn and Rs.869.4 mn respectively, were disbursed in Maha 2006/07 and Yala 2007 respectively.

The Krushi Navodaya credit programme which is implemented by the Lankaputra Bank, with the RDD coordinating the payment of interest subsidy, became operational in March 2007. Whereas under the NCRCS scheme, short term cultivation loans are provided, under the Krushi Navodaya Scheme, medium and long term loans are provided at a concessionary rate for a wide array of activities such as acquisition of agricultural inputs, agro related industries and development of micro irrigation schemes. Maximum loan value is Rs.100,000 for all purposes other than development of micro irrigation schemes for which loans to the value of Rs.350,000 is permitted. In order to develop agriculture, there is a necessity to provide credit along the value chain and by covering crop processing activities, the Krushi

Navodaya Scheme seeks to achieve this to a certain extent. As at 30<sup>th</sup> September 2007, 4573 loans to a total value of Rs.297 mn were disbursed under the Krushi Navodaya Scheme. Credit delivery under the TDP (Revolving Fund) and SPCDP (Revolving Fund) Schemes progressed beyond expectations during the year with almost all funds under the SPCDP (Revolving Fund) being committed in the first half of 2007. Refinance disbursed under the TDP Revolving Fund Scheme and the SPCDP Revolving Fund scheme were Rs.411.4 mn and Rs.540.2 mn respectively. The percentage refinanced under both these schemes is 87 per cent.

Following the sharp escalation of prices of milk products in the world market an urgent need arose for substituting domestically produced liquid milk for imported milk powder in order to avert the negative consequences of high milk powder prices on the nutrition levels of the population and to save foreign exchange. Recognizing the need for large scale processing capacity to achieve this objective, the RDD recommended to the government that a concessionary loan scheme be put in place for the dairy industry. Further, RDD drew the attention of the government to the benefits that could accrue to rural productivity and rural incomes, if concessionary financing was extended to small and medium agro processing ventures which had financing needs exceeding the upper limit for loans under the Krushi Navodaya scheme. Accordingly, in line with these recommendations a special credit scheme for enhancing rural productivity and rural incomes was introduced in the Budget for 2008. Under this scheme interest subsidies would be paid to PFIs for loans extended for establishing dairy units in lagging regions and for small and medium scale crops and liquid milk processing development projects.

FSCs which were introduced to ensure a reasonable price to farmers continued to be operational, with funds being provided under the NCRCS scheme to buyers of agricultural produce under the scheme. However, it had been observed for sometime that even under FSCs, farmers are sometimes compelled to dispose of their produce at prices lower than the agreed prices due to buyers being unwilling to pay the agreed price when it was very much higher than the price prevailing in the open market. Similarly, farmers are reluctant to deliver goods as agreed when the market prices are higher than the contract price. RDD therefore recognized that a more robust mechanism for price risk management needs to be put in place, and decided to explore the possibility of establishing a Commodity Exchange in Sri Lanka to provide facilities for price risk management and

to derive other benefits for the agriculture sector. A working group consisting of persons with wide experience in commodity markets was appointed to work towards this end. As an initial step, RDD coordinated the feasibility study done on establishing a Commodity Exchange by two experts from the National Commodity and Derivate Exchange (NCDEX) of India.

### **Small and Medium Enterprise Sector**

During the year there was considerable demand for funds made available under the Matale Regional Economic Advancement Project Revolving Fund Scheme, with the total allocation of Rs.77 mn for 2007 being committed. Under the EIB Post Tsunami Line of Credit (Contract B Scheme), as at 30/11/2007, 39 loan applications to the total value Rs.672.2 mn had been approved and 18 loans to the total value of Rs 201.4 mn had been disbursed. The RDD was also involved in the negotiations with the ADB on the Small and Medium Enterprise Regional Development Project, a new credit line to be made available to SMEs from 2008 onwards. Total funding for SMEs under this project is to be US\$ 88.89 mn of which US\$ 50 mn will be contributed by the ADB. The Central Bank will be represented in the steering committee to be established to manage this credit line.

### **Micro Finance Sector**

RDD completed negotiations with the Japan Bank for International Cooperation (JBIC) on a credit line for a new poverty alleviation project to be known as Poverty Alleviation Microfinance Programme (PAMP) Phase II. The broad objectives of PAMP II are alleviating poverty, mitigating regional inequality and supporting peace. Accordingly, PAMP II activities will focus mainly on the conflict affected areas and lagging regions, and be operational in fourteen districts from 2008 onwards.

Meanwhile, after termination of the Poverty Alleviation Microfinance Programme (PAMP Phase I) at end 2006, the PAMP Revolving Fund Scheme came into operation in 2007. This scheme was designed to achieve broader geographic coverage than PAMP Phase I and to maximize the allocation for credit delivery out of available resources. Under PAMP Revolving Fund priority has been given to the most vulnerable Divisional Secretariat identified by the Government. With PAMP II also coming into operation in 2008, activities of the PAMP Revolving Fund scheme are to be concentrated in all districts other than those in which PAMP II scheme will be operational. Accordingly, PAMP Revolving Fund and PAMP II together span the whole island. To further

improve access to credit, the number of PFIs of the PAMP Revolving Fund scheme was increased to 14 whereas in the original PAMP scheme, only 6 Regional Development Banks participated. Meanwhile, the activities of the SFLCP Revolving Fund Scheme, progressed satisfactorily in 2007, with beneficiary activities being managed by the respective beneficiary organizations, the People's Companies for Project Beneficiaries on whom the major responsibilities of the management of the scheme were devolved.

### **Credit Supplementation Schemes**

RDD continued to operate 12 credit supplementation schemes to mitigate the risk faced by banks when extending loans to economically important, but risky sectors. As issuing of guarantee cover has now terminated in most of the schemes, issuing of such cover in 2007 was limited to the NCRCS, and Susahana Credit Guarantee schemes only. As at end December 2007, 56,579 loans granted under the NCRCS during the period 2003 to 2007 were under guarantee cover. Other activities related to operation of credit guarantee schemes such as collection of annual premia, processing of claim applications, payment or rejection of claims and following up on post claim recovery continued during the year. The total premia income for the year was Rs.75 mn. On the request of the Ministry of Finance, the RDD also formulated a new credit guarantee scheme for the Micro Small and Medium Enterprise (MSME) Sector which would become operational in 2008. The terms and conditions of this scheme have been designed to encourage project based lending rather than collateral based lending by banks to MSMEs.

### **Regional Offices of the Central Bank**

The RDD continued to oversee the development related activities of the Regional Offices (ROs) of the Central Bank in Anuradhapura, Matale and Matara, while the newly established Policy Review and Monitoring Department commenced monthly monitoring of the progress of ROs. As in the past, the ROs were involved in promoting credit schemes operated by the Central Bank and FSCs. Anuradhapura RO was able to promote large scale cultivation of Maize, by organizing farmers and arranging finance for them under the FSCs. All ROs conducted skill development programmes mostly in relation to livelihood activities undertaken in the particular regions, with the objective of imparting/upgrading skills and thereby increasing the income earning capacity of regional entrepreneurs. In addition to skill development programmes, the ROs in association with relevant departments in the

Central Bank conducted general awareness programmes on Central Bank activities and other important topics. These included programmes on investing in government securities aimed at promoting regional investments in government securities. Other activities undertaken included conducting educational programmes for students, facilitating currency management through acceptance of damaged notes, collection of coins and creating awareness on counterfeit currency etc, providing logistical and other support to Central Bank activities, collection of regional data and dissemination of information through the sale and free distribution of Central Bank publications etc.

## **22. SECRETARIAT**

In 2007, the Secretariat Department facilitated efficient functioning of the Bank through timely procurement of goods and services, continuous assessment and upgrading of systems and procedures, administering and implementing rules and regulations in respect of leave, superannuation funds, local and foreign travel etc.

The department handled 57 tenders during the year and procured capital goods and services and non-capital items amounting to Rs.73.7 million and Rs. 54 million respectively by assuring and maintaining quality, timeliness and competitive prices. The department obtained a cost effective and comprehensive insurance cover for all Bank properties. Meanwhile, with a view to strengthening and improving transparency of existing rules and regulations, action has been initiated to update the Bank manual and it will be released in 2008. During the year, an internal website on departmental activities was launched primarily to enhance the knowledge of bank administrative procedures among employees. The Central Bank Pension Scheme, Widows' and Orphans' Pension Fund (W & OP) and Widowers' and Orphans' Pension Fund (WR & OP) were administered by the Secretariat Department. A total of 1,945 pensioners have been enrolled under these schemes.

In 2007, the department has coordinated and organized various religious and commemorative events and annual ceremonies such as Long Service Awards Ceremony and Independence Day Ceremony.

## **23. SECURITY SERVICES**

The Security Services Department (SSD) continued to strengthen the security measures in the CBSL to protect its employees whilst performing duties, buildings and properties, visitors and the currency consignment in transit. Major actions taken in 2007



included preparations done in the Business Continuity Plan for the critical operations of the CBSL, preparation of a specific contingency plan for SSD, conduct of seven fire drills, conduct of a number of awareness programmes for the CBSL employees on handling emergencies inclusive of fire fighting and first aid, periodical weapon training and live-firing training for security officers, and action to procure the new security equipment (Walk-through Metal Detectors, Explosive Detectors, etc.) and to replace existing Baggage and Cargo Scanners. In addition, the security measures were further tightened with the assistance and cooperation of Government Security forces.

## 24. STATISTICS AND FIELD SURVEYS

The Statistics Department continued its operations on collection, compilation, analysis and dissemination of data on national accounts, prices, wages, labour force and employment and other socio-economic sectors in 2007 as well. The major achievements of the Department during the year were the compilation of a prosperity index for Sri Lanka and its provinces and the conducting of inflation expectation survey on a regular basis. In addition, the Department actively participated in the public awareness programme of the CBSL as a source of resource persons, for training programmes, seminars and media discussions during the reference year. Many officers in both staff and non-staff grades participated in both local and foreign training programmes, workshops and seminars to further their knowledge and skills during the year, which enabled them to improve the quality and productivity of the Department.

### Statistical Surveys

In view of the importance of monitoring on a regular basis, expectations of consumers, investors and business community on future inflation in order to conduct monetary policy effectively, during 2007, the department conducted on a monthly basis Inflation Expectations Survey which was initiated in end 2006. The monthly survey covered a sample of around 300 respondents and responses were collected through different means such as telephone interviews, interviewing at work places and e-mailing.

Results of the each month's survey were submitted to the Monetary Policy Committee (MPC) and the Monetary Policy Consultative Committee (MPCC) at their monthly meetings in the following month. In addition, the department conducted a "survey on user appetite for different denominations of currency notes and coins and switching to the mode of payment

from currency to electronic methods of payments by general public" at the request of the Risk Management Committee of the CBSL. The objective of this survey was to find out the appetite of the general public for different currency denominations as well as to investigate in to their preferences and practices in using alternative means of payments such as credit cards, debit cards, telebanking etc. This survey was limited to a randomly selected 16 Grama Niladhari Divisions chosen from the Divisional Secretariat Divisions of suburban Colombo and had a sample of around 1250 respondents. Further, the department revived the land price survey initiated in 2006 and accordingly, from September 2007 onwards data on land prices were collected on a monthly basis from identified localities in suburban areas around Colombo city based on the prices asked by vendors of land advertised for sale in the weekly newspapers. Reports on the analysis of these prices were submitted to the Financial Systems Stability Committee on request.

### National Income Accounts

Until end of 2006, both the CBSL and the Department of Census and Statistics (DCS) were engaged in the compilation and dissemination of national income estimates. This led to a duplication of work and confusion in the minds of the general public, when two government bodies released two different growth statistics in the country. The international practice followed by many countries has been to compile the national income statistics by the national statistical bureau of the country. It is appropriate that Sri Lanka too follow the same practice. Accordingly, the Central Bank decided to use national income estimates compiled by the DCS from 2007 in its analysis of the performance of the economy, while continuing only forecasting GDP for assessing future growth performance and macroeconomic management. Accordingly, the Department continued with the analysing of growth trends in CBSL publications and provided growth projections when required. This practice is consistent with that adapted in the compilation of price indices and assessing and forecasting inflation. While the DCS compiles the actual price indices and inflation, the CBSL makes use of them in assessing and forecasting movements in inflation, for monetary policy purposes.

### Country Wide Data Collection System (CWDCS)

The Country Wide Data Collection System, which commenced in 1978, was continued with regular collection of information on retail prices of consumer goods, producer prices of agricultural commodities and wage rates pertaining to the informal sector.



Collection of data was accomplished through an island-wide network of government school teachers, who were hired as statistical investigators for 103 data collection centres operated in the island. Data collected under the system is extensively used for compilation of price indices, projections of the price movements for policy decisions, evaluation of the impact of policy changes on prices and estimation of national expenditure and income. Data were also useful for analysing seasonal variations, volatility and regional differences in prices and wages. The sub-sectors covered for collection of wage information under the scheme included paddy, tea, rubber and coconut cultivation, small-scale construction and services. The accuracy of data collection was ensured through regular field supervision of centres according to a pre-scheduled annual programme set at the beginning of the year. As in the past, four regional seminars were conducted in Colombo, Matara, Anuradhapura and Kandy in 2007 with a view to providing further training for the data collectors to improve the accuracy, quality, efficiency and timeliness of their data collection. At these programmes, special sessions were also conducted on contemporary developments in the economy in areas such as the Government Securities market. The effectiveness of such programmes was reflected in the improved awareness and the enthusiasm shown by the teacher investigators.

### **Prices, Wages and Employment**

Recognising the need for a more representative consumer price index and addressing major flaws in the Colombo Consumers' Price Index (CCPI), DCS constructed a new price index called the New Colombo Consumers' Price Index (termed CCPI(N)) in November 2007. The compilation and the weight structure of this index are based on the household expenditure of all urban households in the Colombo district as observed in the Household Income and Expenditure Survey conducted by DCS in 2002 representing contemporaneous purchasing habits. The Department continued with the analysing of movements of consumer prices based on the indices compiled by DCS and issuing a monthly press release on the same.

The Department compiled and analysed four regional price indices for the districts of Anuradhapura, Matale, Matara and Colombo, which measured the aggregate price movements at retail level in these regions. The compilation of regional indices was rationalized by replacing them by provincial consumer price indices, with a view to meeting the need of policy formulation at provincial level in the

context of provincial development. The Department continued to compile these provincial CPIs based on the latest Consumer Finances and Socio Economic Survey (CFS) of 2003/04. The prices necessary for the compilation of these indices were either collected through the CWDCS or by outsourced investigators who had been trained and closely supervised by the Department. Meanwhile, the Department continued with compiling the Wholesale Price Index to analyse movements in producer or wholesale prices at the primary market level.

During the year, the Department also developed a composite CPI covering the entire country with a latest weight structure based on the CFS of 2003/04, capturing the most recent consumption patterns. This index compiled monthly from the beginning of 2007, provided a more realistic picture of the movement of the price level at national level. The Department also compiled an Informal Sector Wage Rate Index (ISWRI) for Sri Lanka, based on the CWDCS wage data.

The Department continued to conduct Annual and Quarterly Public Sector Employment Surveys (QPSES), which were initiated by the Department in 2001, with a view to complementing the quarterly national income estimates and also for finding the levels and trends of public sector employment in the country. The survey covered all Central Government and Public Sector institutions with over 1,000 employees each as reported in the Annual Public Sector Employment Surveys (APSES) of 2006, excluding those under Provincial Councils. The information collected in these surveys helps to assess the effectiveness of the current employment policy of the government and as a measure of improving productivity and efficiency in the public sector. Information collected on labour force and labour market was also analysed by the Department covering the areas of foreign employment, labour relations and labour market reforms as well.

### **Dissemination of Statistics**

During the year, the Statistics Department released its two annual publications titled "Sri Lank Socio Economic Data 2007 – Volume XXX" and "Economic and Socio Statistics of Sri Lanka 2007 – Volume XXI". The statistical tables in the pocket diary 2008 of the Bank were also updated with new information.

The Department made its regular contributions to statutory as well as several other Bank publications during the year. The Monetary Board was kept informed of the current developments with regard to

national income, inflation, prices, wages and the labour market, as and when necessary. The Department continued to routinely update its Departmental website on the local area network, StaNet, and to contribute to the Bank's website throughout the year.

## 25. SUPERVISION OF NON-BANK FINANCIAL INSTITUTIONS

The Department of Supervision of Non-Bank Financial Institutions (SNBFI Dept.) continued its primary function of regulation and supervision of non-bank financial institutions particularly, Registered Finance Companies (RFCs) and Specialized Leasing Companies (SLCs) that are registered under the Finance Companies Act, No. 78 of 1988 (FCA) and the Finance Leasing Act, No. 56 of 2000 (FLA), respectively.

During the year 2007, three companies that had been registered under the FLA were registered under the FCA increasing the total number of RFCs to 32 by the end of the year. With the registration of four new companies under the FLA, the total number of Registered Finance Leasing Establishments (RFLEs) increased to 76 at the end of the year.

### 25.1 Registered Finance Companies (RFCs)

SNBFI Dept. carries out its regulatory and supervisory functions through off-site surveillance and on-site examinations. Off-site surveillance is carried out on a monthly basis for all the companies while on-site examinations are conducted on a pre-planned schedule. The companies that are not subject to on-site examinations during a particular year are subject to spot examinations in which specific areas are selected and examined.

#### (a) Off-site Surveillance

Off-site surveillance of RFCs is carried out by analyzing the information received through periodic returns submitted by the companies with a view of ascertaining the financial condition of RFCs and their compliance with the Directions issued and Rules made by the Monetary Board under the provisions of the FCA.

#### (b) On-site Examinations

On-site examinations are carried out with a view of assessing the asset quality, capital adequacy, management efficiency, earnings, profitability, systems and controls and the status of the corporate governance of RFCs. During the year 2007, SNBFI Dept. conducted seven on-site examinations of RFCs under its examination plan. In addition, spot examinations were

conducted on 24 RFCs that were not subject to comprehensive on-site examinations during the year, to examine selected critical areas such as liquidity, credit administration, capital adequacy and systems and controls.

Findings of both comprehensive on-site and spot examinations were communicated to the Board of Directors and the senior management of the respective RFC and they were directed to take urgent corrective action regarding deficiencies. Prompt corrective actions were taken wherever such actions were required and the Boards of Directors gave firm commitments with specific timeframes for correcting any remaining deficiencies. The SNBFI Dept. closely monitored the progress and corrective actions.

#### (c) Issue of Directions

During the year, two previously issued Directions were replaced with new Directions. In addition, a determination and a set of guidelines were also issued. Further, the Finance Companies (Revenue Recognition and Disclosures in the Financial Statements) Direction, No. 1 of 1995 was revoked.

- The Finance Companies (Lending) Direction, No. 1 of 2007

This Direction was issued revoking the Finance Companies (Lending) Direction, No. 5 of 2006 and it prohibits a finance company to grant any accommodation:

- (i) to a director and/or a relative of a director of the finance company;
- (ii) to its holding company;
- (iii) on the security of its own shares or on the security of the shares of any of its subsidiary companies;
- (iv) to purchase its own shares; or
- (v) on the guarantee or indemnity of a director of the finance company, relative of a director of the finance company or any employee of the finance company.

This Direction also stipulates limits on the accommodations granted for the purchase of shares of or subscription for fully paid shares in a finance company under any scheme implemented for such purpose.

- The Finance Companies (Business Transactions with Directors and their Relatives) Direction, No. 2 of 2007.

This was issued replacing the Finance Companies (Business Transactions with Directors and their Relatives) Direction, No. 6 of 2006 as it became necessary to enable finance companies to accept time and savings deposits from its directors and their relatives and payment of interest on such deposits.

#### **(d) Issue of Guidelines and Determinations**

The Finance Companies (Maintenance of Savings Accounts for Minors) Guidelines, No. 1 of 2007 was issued requiring RFCs to allow transfer of balances in savings accounts opened for minors after a period of five years to an account maintained in an authorized deposit taking institution for the same person with the instructions of their parents or legal guardians and withdrawing of the money from the minors' accounts for specific purposes such as education or medical treatment.

Further, the Monetary Board made a Determination under section 46 of the FCA to include the face value of unsecured debentures, that have features specified in the determination, in the capital funds of the RFC that issued such debentures.

### **25.2 Registered Finance Leasing Establishments (RFLEs)**

#### **(a) Registration of Finance Leasing Establishments**

During the year under review, 4 public companies were registered under the provisions of the FLA. Accordingly, at the end of 2007, the total number of RFLEs stood at 76, comprising 15 LCBs, 9 LSBs, 32 RFCs and 20 SLCs.

#### **(b) Issue of Directions**

During the year 2007, a new Direction, the Finance Leasing (Debt Instruments) Direction, No. 1 of 2007 was issued stipulating requirements that should be fulfilled by SLCs in raising funds through issue of debt instruments.

#### **(c) Monitoring of SLCs**

SNBFI Dept. continued its off-site surveillance of SLCs on a monthly basis during the year 2007 (other RFLEs, i.e., LCBs, LSBs and RFCs regulated and supervised under separate statutes). In addition, 2 on-site examinations and 17 spot-examinations of SLCs were conducted by the Department during the year. On-site examinations were conducted to appraise the financial performance, risks that a particular SLC is exposed to and to evaluate the effectiveness

of the systems and controls. These examinations were also used to ascertain the accuracy of the financial reporting and to check the compliance with the Directions by SLCs. The companies that did not comply with the Directions were directed to take corrective action within a specific period of time and the Department closely monitored the progress relating to action taken by them.

### **25.3 Failed Finance Companies**

The administration and management of nine failed finance companies had been vested in the Monetary Board since 1988 under the provisions of the FCA. Of these, one company was wound up in 2007 bringing the total number of companies that were wound up to four. The process of liquidation continued in the case of four companies. In respect of the other company, a petition was filed in the District Court of Colombo appealing to appoint a liquidator to wind up the affairs.

During the year 2007, the audit firm and the two legal firms, which were assigned the task of investigating and recommending the course of action that can be taken in respect of failed finance companies, submitted their reports to the Central Bank. Those reports and other necessary information were forwarded to relevant authorities to take appropriate action based on the findings and recommendations.

### **25.4 Unauthorized Conduct of Finance Business**

The Department continued investigations under section 11(2) of the FCA into the affairs of the institutions, which were allegedly engaged in finance business without legal authority. During the year, the Department continued with the legal action initiated earlier against the companies, which failed to comply with the Directions issued by the Monetary Board after determining that such companies had been conducting finance business without legal authority.

There has been a marked decline in the number of inquiries/complaints received in respect of persons conducting finance business in an unauthorized manner. This may be partly due to the action taken by the Central Bank on a continuous basis regarding such persons and the intensified public awareness programmes.

### **25.5 Public Awareness Programmes**

The Department continued to educate the public mainly on matters relating to the unauthorized conduct of finance business. The public awareness programmes implemented by the Department included the following:-

**(a) Publications in newspapers:**

- (i) With a view to regularizing the institutions engaged in finance business without authority, a press notice was published in February 2007 requiring all such institutions to discuss with their auditors and lawyers and to apply for registration under the FCA. In response, several companies made requests and the Department is appraising those proposals.
  - (ii) Monthly press notice with an explanatory note providing the definition of deposits, categories of institutions/organizations authorized to accept deposits under different laws and a list of institutions authorized by the Central Bank to accept deposits was published. These notices were published on a monthly basis jointly with the Bank Supervision Department.
  - (iii) Special press notices were published when some persons tried to mobilize public funds through indirect means such as fund management and investments etc.
- (b) **Leaflets:** A leaflet titled “a notice to the public” was published and distributed among the public through RDBs and RFCs.

**25.6 Regulation of Micro Financing Institutions**

It has been identified that there are a large number of institutions engaged in micro financing business throughout the country. As these institutions are not regulated or monitored through a specific regulatory and supervisory arrangement, it has been decided that certain regulatory requirements should be imposed on such institutions. SNBFI Dept. prepared a draft Micro Finance Institutions Act (MFI) and submitted it to the Monetary Board. On the instructions given by the Monetary Board, the proposed regulatory and supervisory arrangement is being revised in order to entrust the regulatory and supervisory functions to relevant government authorities, where it is practicable.

**26. TRAINING**

During the year 2007, the training function had more emphasis on the development of a multi-skilled staff in the CBSL. Recognizing the importance of having a competent and skilled staff in the Bank, opportunities were provided for its staff to participate in programmes conducted by reputed institutions, both locally and abroad. This new culture helped the staff to improve their skills and competencies

enabling them to carry out the responsibilities entrusted to them more efficiently and effectively.

The Bank in 2007, provided opportunities for 162 officers to participate in training programmes conducted abroad, while 1,455 were nominated for participation in training programmes conducted by reputed training institutions locally. In addition to this, the department arranged 05 Management Development programmes for 127 senior officers of the Bank. The department also made arrangements to conduct structured programmes on ‘Micro Finance’ for 25 participants of CBSL and other commercial banks, a ‘Credit Derivatives’ programme for 24 participants and a ‘Risk Management’ programme for 79 participants to meet the specific training needs of departments. In order to develop communication skills of the officers in the Bank, the department conducted 02 programmes on ‘Grammar and Communication for Business’ for 40 officers with the assistance of the British Council. In addition, a ‘Speech Craft’ programme was conducted for 25 officers of the staff class grade III and IV in 2007 by the Colombo Toastmasters Club to improve their communication and presentation skills.

The Bank, as in the past, continued to provide facilities for its staff to acquire postgraduate qualifications from reputed universities in the UK, USA, Canada and Australia under the Central Bank Scholarship Scheme. Accordingly, 04 officers commenced their postgraduate studies in 2007, while 05 officers resumed duties in the Bank after successfully completing their postgraduate studies abroad.

With a view to imparting knowledge gained through foreign training programmes among fellow members, officers who have participated in training programmes were requested to conduct regular seminars in the Bank. Under this scheme, 34 seminars were conducted on Wednesdays and Thursdays by CBSL officers. Apart from this, 04 eminent speakers were invited to conduct presentations on important subjects for the benefit of all staff in the Bank.

Arrangements were also made for two groups of officers to visit Riksbank in Sweden to familiarize themselves with the procedures adopted by the Riksbank in conducting Monetary Policy, GDP estimating and Inflation Forecasting.

**27. WELFARE DEPARTMENT**

The Welfare Department continued to provide its facilities to the staff in an efficient and effective manner with a view to maintaining a healthy group

of employees in the Bank. These facilities were extended to improve the well being of the dependents of the employees and pensioners as well. The facilities were provided under the Medical Benefit Scheme (MBS), Housing Loan Scheme and other Staff Benefit Schemes including Provident Fund Loans, Medical Clinic and providing of Railway Warrants. In the year under consideration, the Welfare Department aimed at simplifying the process of granting loans, automating of welfare functions, revision of medical facilities and introducing a Social Benefit Scheme for contractual employees. Under the Social Benefit Scheme, the Department was able to introduce an Insurance Scheme for the security staff on contract during the year. As a part of its welfare oriented strategic role, a committee was appointed to look into the ways of simplifying the loans and certain progress has been made during the year.

The Department has efficiently catered to the requirements of the staff by disbursing loans within a short period of time. The number of housing loans approved was 121 while the number of PF loans granted including SBS loans, computer loans, vehicle loans etc. were 1046. In response to the request made by the employees, trade unions and pensioners, the Department had several discussions with all stakeholders regarding the possible revision of the existing MBS. With the aim of broadening the Fund for Contributory Medical Benefit Scheme and to extend these facilities to pensioners and their spouses, the amount of contribution from pensioners per month was increased from Rs.100 to Rs.150.

A self-service system was introduced in restaurants for better service and to have a better choice on the part of the employees. The Department conducted a series of lectures for the benefit of the employees on various topics and also assisted the Seva Vanitha Unit to conduct programmes on health and general topics, which are beneficial to the staff of the Bank.