

Bank of Ceylon – 2015

The audit of the financial statements of the Bank of Ceylon ("the Bank") and the consolidated financial statements of the Bank and its Subsidiaries ("Group") for the year ended 31 December 2015 comprising the statements of financial position as at 31 December 2015, and the statements of profit or loss, statements of comprehensive income, statements of changes in equity and statements of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information, was carried out under my direction in pursuance of provisions in Article 154(1) of the Constitution of the Democratic Socialist Republic of Sri Lanka. In carrying out this audit I was assisted by a firm of Chartered Accountants in public practice. The financial statements of the Subsidiaries were audited by the firms of Chartered Accountants in public practice appointed by the members of the respective Subsidiaries.

This report is issued in terms of Article 154 (6) of the Constitution of the Democratic Socialist Republic of Sri Lanka.

1.2 Special Statutory Provisions for Bank

The Bank has been exempted from the provisions of Part II of the Finance Act, No. 38 of 1971 by an order of then Minister of Finance published in the Government Gazette No. 715 of 14 May 1992 by virtue of powers vested in him by Section 5 (1) of the said Finance Act. The Bank is also exempted from all Treasury and Public Administration Circulars as decided by the Cabinet of Ministers and conveyed by the Secretary to the Treasury by his Circular No. EA02/BC/PB/01 dated 10 April 1992.

1.3 Board's Responsibility for the Financial Statements

The Board of Directors ("Board") is responsible for the preparation of these financial statements that give a true and fair view in accordance with Sri Lanka Accounting Standards and for such internal control as the Board determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

1.4 Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Bank's preparation of the financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control. An audit also includes evaluating the appropriateness of accounting

policies used and the reasonableness of accounting estimates made by the Board, as well as evaluating the overall presentation of the financial statements.

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

2 Financial Statements

2.1 Opinion

In my opinion, the financial statements give a true and fair view of the financial position of the Bank and the Group as at 31 December 2015 and of its financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

2.2 Comments on Group Financial Statements

2.2.1 Group's Financial Statements and Basis of Consolidation

The financial statements of the Bank comprised the consolidation of the financial statements of the Domestic Banking Unit, the Off Shore Banking Unit, Islamic Banking Unit and the Foreign Operations that are an integral part of the Bank. The Group financial statements comprised the consolidation of the financial statements of the Bank, its Subsidiaries and Associates in compliance with Sri Lanka Accounting Standards (SLFRS/LKAS).

The position of the investments of the Bank as at 31 December 2015 and as at the end of the preceding year in each Subsidiaries and Associates were as follows.

Name of the Company	Position of Investment		Ownership as a percentage of Investment	
	2015 Rs. Million	2014 Rs. Million	2015	2014
Subsidiaries				
- Quoted Companies				
Property Development PLC	860	860	95.55	95.55
Merchant Bank of Sri Lanka & Finance PLC	2,255	2,123	74.49	72.14
- Unquoted Companies				
BOC Management and Support Services (Pvt) Ltd	1	1	100.00	100.00
BOC Property Development and Management (Pvt) Ltd	1,010	1,010	100.00	100.00
BOC Travels (Private) Ltd	2.5	2.5	100.00	100.00
Hotels Colombo (1963) Ltd	101	101	99.99	99.99
Merchant Credit of Sri Lanka Financial Services Ltd **	-	132	-	80.09
Bank of Ceylon (UK) Ltd	2,684	2,684	100.00	100.00
Total Investments in Subsidiaries	6,913.5	6,913.5		
Less-Provision for Impairment	(700)	(700)		
Net Investments in Subsidiaries	6,213.5	6,213.5		

Associates

- Unquoted Companies

Transnational Lanka Records Solutions (Pvt) Ltd	20	20	24.69	24.69
Ceybank Asset Management (Pvt) Ltd	31	31	43.36	43.36
Southern Development Financial Company Ltd	25	25	41.67	41.67
Mireka Capital Land (Pvt) Ltd	750	750	40.00	40.00
Lanka Securities (Pvt) Ltd	42	42	41.60	40.92
Total Investments in Associates	868	868		
Less-Provision for Impairment	(25)	(25)		
Net Investments in Associates	843	843		
Total Investments	7,056.5	7,056.5		

** The Merchant Credit of Sri Lanka Financial Services Ltd and the Merchant Bank of Sri Lanka Savings Bank Ltd have been amalgamated with the Merchant Bank of Sri Lanka & Finance Ltd with effect from 01 January 2015.

2.3 Comments on Financial Statements of the Bank

2.3.1 Compliance with Sri Lanka Accounting Standards (SLFRS and LKAS)

The following observations are made.

- (a) **LKAS 39 - Financial Instruments, Recognition and Measurement** - The interest income on impaired loans should be recognized on effective interest rate. However, the Bank had not recognized revenue on impaired loans as requested by the Standard. Further in practically, the Bank had continued to suspend the interest income on non-performing loans as per the directions given by the Central Bank of Sri Lanka (CBSL) and as such suspended income had been added to the interest income and loans as an adjustment for compilation of the financial statements.
- (b) **LKAS 24 – Related Party Disclosures** - An independent and Non-executive Director of the Bank is being working as a Chief Executive Officer (CEO) of a Private Limited Company since 2009. Despite the fact, that Bank had purchased a Symantec Endpoint Virus Protection Software (5000 licenses) at a cost of USD 40,000 from this company on 28 December 2015. However, this transaction had not been disclosed as a note to the financial statements of the Bank for the year under review.

2.3.2 Un-reconciled and Unidentified Differences

The following observations are made.

- a) A difference of Rs. 3.5 million was observed between the related party transactions shown in the financial statements and the balances disclosed in the report issued by the Central Bank of Sri Lanka (CBSL).

b) The following reconciling items appear in the Central Bank reconciliation as an un-reconciled balances as at 31 December 2015.

i) The un-reconciled inward cheque return balance as at 31 December 2015 was Rs. 134.7 million. According to the management explanations the cheque clearing process is conducted with the involvement of a private company. Further, that company conducts this process in two sessions, morning and evening. At the end of the reporting date, the differences are the result of the inward cheque return which cannot be identified at the same day itself in Bank's general ledger (GL). Therefore inward cheque return is subsequently adjusted in the GL in next day morning and such balances are appeared as outstanding at the reconciliation date.

It was identified that the Bank can recognize the inward cheque return amount before preparing the reconciliation. However, system has configured to post inward return cheque amount in the cash at bankers account on the following day.

ii) The un-reconciled balances relating to outward slip transactions as at 31 December 2015 amounted to Rs. 378 million and the Bank had not adjusted these amounts in GL on the same day due to high volume of transactions.

2.3.3 Accounts Payable and Receivable

The following observations were made.

- (a) The amounts payable aggregating USD 193,640.90 had been shown as suspense account balance for last 5 years without being taken necessary action to settle them. Further, the details of the true owner had not been submitted for audit.
- (b) A sum of USD 3,597,279.59 which represents more than 90 per cent of the total outstanding remained unrecovered for more than 3 ½ years.
- (c) The Bank had not consulted the Central Bank about the procedure to be followed with regard to the amounts lying in suspense account totalling USD 3,743,008.43 which represent as account closed balances due to sanctions imposed on Iran.
- (d) The Bank is maintaining several contingency accounts which include unclaimed pay orders, pawning excess, dormant accounts under other liabilities. The balance stood in this account as at 31 December 2015 was Rs. 388.9 million. However, the Bank does not have a facility to maintain an ageing report centrally in order to transfer these unclaimed balances to the Central Bank of Sri Lanka which unclaimed for over 10 years.

2.3.4 Non – compliance with Laws, Rules and Regulations

The following non-compliance with Laws, Rules and Regulations were observed in audit.

Reference to Laws, Rules and Regulations

Non-compliance

a) Central Bank of Sri Lanka (CBSL) Direction No. 3 (6) (v) (b) – Risk Assessment

Assessments of risk management of the Subsidiaries were not taking place on a timely manner.

b) Section 05 of CBSL Direction No.03 of 2009 - Foreign Exchange Transactions

The Bank had not complied with the following procedures.

- i) Comprehensive regular review on Treasury limits
- ii) Incorporating limits in Finacle Treasury
- iii) Limits not monitored prior to Finacle Migration
- iv) Obtaining relevant approval limits exceptions configured to process.
- v) Limits not monitored by Treasury Middle Office

3. Financial Review

3.1 Financial Results

According to the financial statements presented, the operations of the Group had recorded a pre-tax net profit of Rs. 25,490 million as compared with the corresponding pre-tax net profit of Rs. 21,431 million for the preceding year, thus indicating an improvement of Rs. 4,059 million or 18.9 per cent in the financial results. The operations of the Bank excluding Subsidiaries during the year under review had resulted in a pre-tax net profit of Rs. 25,279 million as compared with the pre-tax net profit of Rs. 20,291 million in the preceding year, thus indicating an improvement of Rs. 4,988 million or 24.6 per cent in the financial results.

The following table gives a summary of the financial results of the Bank and the Group at various stages for the year under review and the preceding year.

	Bank			Group		
	2015 Rs. Million	2014 Rs. Million	Change (%)	2015 Rs. Million	2014 Rs. Million	Change (%)
Interest income	114,159	107,394	6.29	118,498	111,951	5.85
Interest expense	(66,419)	(68,944)	(3.66)	(68,381)	(71,197)	(3.96)
Net interest income	47,740	38,450	24.16	50,117	40,754	22.97
Net fee and commission income	7,838	8,100	(3.23)	8,082	8,324	(2.90)
Net gain from trading	3,968	4,860	(18.35)	3,985	5,038	(20.90)
Net gain from financial investment	610	2,881	(78.83)	642	2,900	(77.86)

Other operating income	5,269	2,222	137.13	7,015	3,624	93.57
Total operating income	65,425	56,513	15.77	69,841	60,640	15.17
Impairment (charges)/reversal for loans and other losses	(7,317)	(7,911)	(7.51)	(7,780)	(7,931)	(1.90)
Net operating income	58,108	48,602	19.56	62,061	52,709	17.74
Total operating expenses	(28,013)	(24,260)	15.47	(31,804)	(27,635)	15.09
Operating profit before Value Added Tax (VAT)	30,095	24,342	23.63	30,257	25,074	20.67
VAT on financial Services	(4,816)	(4,052)	18.85	(4,873)	(4,105)	18.71
Operating profit after VAT	25,279	20,290	24.58	25,384	20,969	21.05
Share of profit / (loss) of Associate Companies before tax	-	-	-	107	462	76.84
Profit before income tax	25,279	20,290	24.58	25,491	21,431	18.94
Income tax expense	(7,921)	(6,717)	17.92	(8,103)	(7,059)	14.79
Profit for the year	17,358	13,573	27.87	17,388	14,372	20.98

The increase of Gain on revaluation of foreign exchange which include other operating income by Rs. 2,339 million or 8,530 per cent and increase of interest income by Rs. 6,765 million or 6.3 per cent were the main reasons attributed for the improvement in the financial result of the Bank for the year under review.

3.1.1 Value Addition Statement

	2015 Rs. Million	2014 Rs. Million
Value Added		
Income earned by providing banking services	128,078	118,513
Cost of Services	(55,361)	(59,923)
Value Added by Banking Service	72,717	58,590
Non-Banking Income	4,837	8,033
Impairment Charges for loans and other losses	(7,317)	(7,911)
	70,237	58,712
Value Allocation		
To Employees	16,744	13,716
To Government		
Dividends paid to GOSL	6,346	6,846
Super Gain Tax	2,016	-
Income Tax	7,951	5,602
Value Added Tax	4,816	4,052

To Providers of External Funds	22,008	19,462
To Expansion and Growth	10,356	9,034
	70,237	58,712

The following observations were made in this regard.

- a) Value added by banking services shown a growth of 24 per cent to stand at Rs. 72,717 million as compared with Rs. 58,590 million in the previous year and this was a considerable increase as compared with the year 2014.
- b) Value allocation to employees and providers of external funds had increased by 22 per cent and 13 per cent respectively during the year 2015 as compared with the year 2014.
- c) The profit after tax for the year 2015 amounted to Rs. 17,358 million and it was a 27.9 per cent increase with compared to Rs. 13,573 million profits after tax reported in 2014. However, the distribution of dividends to the Government had been decreased by 7 per cent or from Rs. 6,846 million in the year 2014 to Rs. 6,346 million in the year 2015.

3.2 Analytical Financial Review

----- Significant Accounting Ratios -----

Certain significant accounting ratios for the year under review and preceding five years are given below.

		(percentage)					

	CBSL Norms	2015	2014	2013	2012	2011	2010
(i) Capital Adequacy Ratio (Tier 1)	5.00	9.1	9.5	8.4	8.3	7.8	10.3
(ii) Capital Adequacy Ratio (Tier 1+2)	10.00	13.1	13.6	12.1	11.5	10.9	13.7
(iii) Return on Average Assets	-	1.7	1.6	1.4	2.1	2.1	1.6
(iv) Liquidity Ratio	20.00	28.2	30.8	27.7	21.8	23.4	28.7
(v) Return on Average Equity	-	22.2	20.5	22.2	31.2	33.5	24.0
(vi) Interest Margin	-	3.3	3.1	3.3	3.83	3.34	3.14
(vii) Cost to Income Ratio	-	43.7	44.0	49.1	42.7	51.1	53.7

The following observations are made in this regard.

- i) Return on Average Equity of the Bank has gradually decreased from 33.5 per cent in the year 2011 to 22.2 per cent in the year under review. As such it was observed that the Bank had not taken action to achieve an adequate return by resourcefully managing the Bank capital since 2011. Although there had been a gradual increase in the Bank's reserves, the Bank had not taken action to achieve a higher ROAE value in 2015 as it had been done in the year 2014 by duly investing the increased capital.
- ii) Net Interest Margin improved marginally in the year under review to 3.3 per cent, as compared with that of 3.1 per cent in the previous year. This is primarily due to increase of interest income from financial investments, interest from term loans and personal loans through improved loan portfolio and the 4 per cent decrease of interest expenses.

4. Operating Review

4.1 Loans Administration

(a) Non-Performing Loans (NPA) and Advances

- (i) At the audit test check it was revealed that certain loans and advances had been granted without proper evaluation of securities mortgaged and credit worthiness of the customers and the audited financial statements of the customers and legal documents relating to establishment of the business had not been obtained on a timely manner. Further, correspondence files for advances had not been updated with relevant documents and information. In certain instances the insurance policies against the mortgaged properties had not been obtained/ duly renewed. Further, regular inspections had not been carried out on mortgaged properties and in certain instances; letter of set off had not been taken from the borrowers concerned.

Moreover, the Bank does not have a system to obtain an automated central liability report which captures all the facilities given to customers under different operating platforms. Instead management do perform manual compliance of the reports extracted from different systems Integrated Comprehensive Banking System (ICBS), Lease and Trade Finance System. It was further observed that total exposure of certain significant customers have not been captured as individual significant loans (ISL) even though the combined exposure of the customers were above the ISL threshold of Rs. 100 million.

- (ii) Non-performing loans and advances ratio for a period of 3 years from 2011 to 2013 had been increased from 2.1 per cent to 4.3 per cent and the main reason for this was the increase of non-performing advances in pawning portfolio as a reaction to the decline in gold prices. Further, the Bank was capable of reducing the non-performing loan ratio of 4.3 per cent in 2013 to 3.8 per cent as at the end of the year 2014 transferring an amount of Rs. 19,965,835,972 from the above non-performing loan account to an assets account. However, the non-performing loan ratio had increased once again to 4.3 per cent by the end of year 2015 as compared with the year 2014 and it was an increase of 13.15 per cent. The rise in non-performing loans happened to be the main cause for this

- (iii) Non Performing Advances (NPA) of the selected 07 Branches had also reflected higher percentages for the year under review.

Branch Name	Total Advance Rs.	Total NPA Rs.	NPA as a Percentage of Total Advance
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Atchuvvely	776,572,646	532,695,076	68.60
Kopay	405,875,196	176,574,934	43.50
Mawanella	1,982,938,467	858,425,824	43.29
Chunnakam	1,216,022,982	502,009,515	41.28
Fish Market Peliyagoda	959,485,418	324,293,063	33.80
Kilinochchi	972,588,487	310,999,353	31.98
Fifth City Branch	1,187,753,121	290,640,646	24.47

- (iv) The non-performing loans and advances of major ten customers relating to loans and advances as at the end of the year under review were stood at Rs. 5,044,828,796. Details are shown below.

Type of Loans and Advances	Non-performing Amount as at 31 December 2015 Rs.
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Loans	3,669,994,752
Overdraft	994,818,508
Credit Card	11,495,724
Leasing	368,519,812
Total	5,044,828,796

- (v) Outstanding loan balances as at 31 December 2015 relating to 316 loans over one million within 83 Branches which had not been recovered a single installment was Rs. 4,929,579,209.
- (vi) Six Branches of the Bank had recorded the highest non-performing percentages against the total overdrafts facilities provided by those Branches. The total overdraft balance as at 31 December 2015 was Rs. 1,307,193,267 and the total non-performing as at that date was Rs. 743,558,187 ranging from 39.96 per cent to 89.42 per cent.

Name of the Branch	Total Overdraft Balance as at 31 December 2015 Rs.	Total NPA Overdraft as at 31 December 2015 Rs.	NPA as a Percentage of Total Overdraft
Fish Market - Peliyagoda	264,239,930	236,290,701	89.42
Mawanella	149,459,874	94,987,349	63.55
Fifth City Branch	310,929,933	150,993,703	48.56
Bulathsinhala	91,960,147	44,387,406	48.27
Maradana	316,397,641	147,283,071	46.55
Kaduruwela	174,205,742	69,615,957	39.96
Total	1,307,193,267	743,558,187	

- (vii) The Card Centre of the Bank had issued 80,628 credit cards as at 31 December 2015 and the total outstanding balances as at that date amounted to Rs. 2,861,176,429. Out of this, a sum of Rs. 162,881,341 or 5.69 per cent were categorized as Non-performing. The details of that total Non- Performing Advances were as follows.

Category	Amount Rs.
Overdue	4,015,861
Substandard	11,355,294
Doubtful	10,769,335
Loss	136,740,851
Total	162,881,341

- (viii) The number of card holders who had not paid even a single installment since obtaining the cards up to 31 December 2015 stood at 71 and the total outstanding amount was Rs. 1,653,083. Further, the capital and interest written off during the year under review were Rs. 20,483,533 and Rs. 31,127,582 respectively.

(b) Providing Overdraft Facilities

Temporary overdraft amounting to Rs. 100 million had been granted to a customer for a period of 30 days since 15 December 2014 on the request of General Treasury with the

approval of Board of Directors to meet urgent financial commitments. Further, by a letter dated 25 June 2015 from Deputy Secretary to the Treasury, it had been requested to enhance the Temporary Overdraft (TOD) facility up to Rs. 225 million. Accordingly, the Board had approved the enhancement of Rs. 225 million on 07 July 2015 and extended the overdraft period for another 6 months from the letter dated 03 July 2015. This TOD of Rs. 225 million is due as at the end of the year 2015.

(c) Providing Leasing Facilities

The following observations were made in this connection.

- (i) The following 07 Branches of the Bank had recorded the highest non-performing advances of Rs. 366,379,061 as at 31 December 2015 relating to leasing business. Details are given below.

Name of the Branch	Total Outstanding Balance as at 31 December 2015 Rs.	Total NPA as at 31 December 2015 Rs.	NPA as a Percentage of Total Outstanding
Dehiwala Super Grade	188,650,508	68,834,682	36.49
Kaduwela	135,523,771	43,451,315	32.06
Mirigama	78,965,861	25,016,384	31.68
Fish Market Peliyagoda	159,919,153	26,868,987	16.80
Malabe	295,565,751	41,879,092	14.17
Corporate Relations	561,420,527	68,820,405	12.26
Metro	909,984,626	91,508,196	10.06
Total	2,330,030,197	366,379,061	

- (ii) It was further observed that approximately 44.5 per cent of total leasing exposure of the Bank as at 31 December 2015 consists of lending to the Government of Sri Lanka and State Owned Entities (SOEs).

(d) Providing Pawning Facilities

The following observations were made.

- i) “Ran Surekum Naya Sewa” portfolio of the Bank as at 31 December 2015 is as follows.

	Capital Outstanding Rs.	Interest Receivables Rs.
	-----	-----
Regular	47,863,462,464	2,414,330,715
Non-Performing	6,400,536,722	1,763,579,051

- ii) Dud, fake and robbed articles valued at Rs. 199.3 million and the accrued interest (approximately) of Rs. 92.3 million had been found in respect of 176 Branches as at 31 December 2015.

(e) Facilities granted to Government Sector

The following observations were made.

- i) Facilities granted to Paddy Marketing Board amounting to Rs. 5.128 billion

The Bank had granted the loans aggregating Rs. 5.128 billion to the Paddy Marketing Board during the year under review based on a pending letter of comfort to be issued by the General Treasury to purchase paddy. The payments were due within one year and Bank had not received the General Treasury comfort letter to date. In the meantime, a loan of Rs. 3.5 billion granted on similar basis during the year 2012 had remained outstanding as at 31 December 2015.

- (ii) Necessity of validating estimates and assumptions considered in the impairment assessment of loss making State Owned Enterprises.

It was noted that approximately 37 per cent of total credit exposure of the Bank as at 31 December 2015 consist of lending to the Government of Sri Lanka including the State Owned Enterprises (SOEs). In the assessment of impairment, the Bank had considered certain significant SOEs as non-impaired on the grounds that those were attached to the Government. Certain such significant considerations are given below.

Name of the State Owned Enterprise	Significant Considerations	Total Outstanding as at 31 December 2015 Rs. Million
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Ceylon Petroleum Corporation	Treasury Guarantee of USD 900 million.	
	- On balance sheet	97,689
	- Off Balance sheet	62,421
Paddy Marketing Board	Unsecured loan balances	
	- Capital Outstanding	5,128
	- Interest Outstanding	4,600

Lanka Sathosa Limited	Unsecured loan balances (Extended the repayment period without extending the Treasury guarantee period.)	
	- Capital Outstanding	6,992
	- Interest Outstanding	219
Urban Development Authority	Unsecured loan balances	
	- Capital Outstanding	11,000
	- Interest Outstanding	264

The management is required to assess the counterparty credit risk attached to the loss making state owned enterprises in detail, considering the possibility of the government to settle the dues on behalf of the loss making institutions at a point of a default.

(f) Written off Loans and Advances

Capital and interest relating to outstanding loans and advances written off during the last four years are given below.

Year	2015	2014	2013	2012
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Capital (Rs.)	109,397,125	54,690,892	102,993,177	44,316,750
Interest (Rs.)	98,536,345	67,615,763	247,395,147	138,161,976
Number of loans written off	554	424	285	315

The following observations were made in this connection.

- i) Total capital written off in the year 2015 was Rs. 109,397,125 and it represents 554 customers of the Bank. However, the Bank had written off Rs. 55,151,756 as a capital portion of a company during the year 2015 and it represent 50.41 per cent of total capital written off in the year 2015.
- ii) The Bank had granted a Term Loan facility of USD 1.60 million to a shipping company for purchase a Merchant vessel by mortgaging the ship and on a corporate guarantee provided by a related company. According to the Supplementary Memorandum to the Board of Directors dated 08 July 2015, the Board of Directors approved, accepting Rs.75 million (USD 531,537.92) as full and final settlement of the total liability of the shipping company and written off the remaining balance of Rs. 108,015,611 due from the said shipping company without being taken actions to arrest the ship to recover the due or get insurance claim from the insurance company as the compensation entitle to the Bank on the ship

4.2 Market Share of the Bank

Although, the Bank had owned the status of market leader in the banking sector, it was observed that the acquired market share in the banking sector had been slightly decreased during the last five years under the current market condition. Details are shown below.

(a) Loans and Advances

	Year				
	2015	2014	2013	2012	2011
Total Loans and Advances of the Bank (Rs. Million)	687,042	565,425	550,718	501,041	406,039
Total Loans and Advances of the Market (Rs. Million)	3,477,005	2,775,708	2,546,105	2,304,056	1,905,682
Market share of the Bank (%)	19.76	20.37	21.63	21.75	21.31

(b) Deposits

	Year				
	2015	2014	2013	2012	2011
Total Deposits of the Bank (Rs. Million)	789,877	692,371	615,059	494,901	432,070
Total Deposits of the Market (Rs. Million)	3,772,910	3,226,612	2,883,661	2,450,490	2,037,294
Market share of the Bank (%)	20.94	21.46	21.33	20.20	21.21

(c) Ratings

The position of the Bank in the banking sector rating for the year 2015 was as follows.

i) Global Rating

Fitch Ratings reaffirmed the USD senior notes "BB- with stable outlook" while Moody's reaffirmed "B1 with stable outlook" during the year 2015. However, in March 2016 Fitch Ratings revised the BOC's rating from "BB- stable outlook" to "B+ with negative outlook" due to revision of the sovereign ratings.

ii) Local Rating

Fitch Ratings Lanka Limited reaffirmed the Bank's rating as "AA+ (lka) with stable outlook" and ICRA Lanka Limited reassigned "(SL) AAA with stable outlook" during the year 2015.

4.3 Management Weaknesses

The following observations are made.

a) Legal Cases Filed against the Bank

Hundred and seventy seven (177) legal cases had been filed by the outsiders against the Bank and out of those, 05 cases which filed by three persons had been identified as unfavourable to the Bank as at 31 December 2015 and with regard to 02 cases, the judgement had already been delivered against the Bank confirming the payment of Rs. 5.6 million as a compensation to the Agriculture Insurance Board.

In addition to that, the judgment for other unfavourable cases with regard to money recovery matters to be delivered and if the judgement will be against the Bank, it should be required to pay a compensation of Rs. 171.15 million to the outsiders.

b) Realization of Account Payee Cheque

Personal Branch of the Bank had realized four crossed cheques ("A/C Payee Only amounting to Rs. 1,001,000 ") in 2011 drawn in favour of third parties without considering the laws, rules and banking practices.

c) Non availability of Lease Agreements

The Bank had not possessed legally binding lease hold agreements for 22 leasehold lands obtained from the Government to construct office buildings. In some instances official correspondents such as letters issued by respective authorities were available and in certain cases the Bank does not have any evidence to substantiate the rights to use such leasehold properties.

d) Non availability of Appropriate Review Process of Actuarial Valuation Report

It was observed that the Bank does not have an appropriate review process to review the actuarial valuation reports with respect to the employee benefits. During the review of current year's actuarial valuation report, it was revealed that several discrepancies with regard to the data sent to Actuary and Draft Valuation Reports etc. Such discrepancies were rectified subsequently.

Therefore, it is imperative that management establish a proper review mechanism in order to ensure accuracy and the reasonability of actuarial valuations. It has been experienced that due to the delay in appointment of the actuary and due to the erroneous data submitted to the actuary, the finalization of actuarial valuation became tedious.

e) Necessity of Revisiting the Existing Employee Benefit Arrangements

It was observed that the Bank should revisit the existing employee benefit arrangements of the Bank and restructure if required. The following observations were made with regard to the existing employee benefit arrangements of the Bank.

- i) As at 31 December 2015, the fair value of the planned assets of the Widows'/Widowers' and Orphans' Pension Fund of the Bank had been exceeded the liability of the Fund by Rs. 4 billion. (2014 - Rs. 2.8 billion) which have not been recognized in the financial statements.
- ii) The Bank does not have Trust Deeds for the Medical Fund of Pensioners' and Widows'/Widowers' and Orphans' Pensioners' and Bank of Ceylon Post 96 Pension Fund. Unavailability of trust deeds indicate the absence of appropriate legal framework for these employee benefits which may result in confusion in operations of these funds and disclosure requirements in the financial statements.

f) Automated Teller Machine (ATM) Chip Liability Shift

According to the Global Security Bulletin No. 05 of 15 May 2013 which has been shared with the Bank's staff personnel in May 2013, the domestic ATM transaction chip liability shifts will apply in Bangladesh, Bhutan, Maldives, Nepal, and Sri Lanka with effect from 16 October 2015. Apart from the initial notification, the Bank had received several reminders from MasterCard during 2015 where MasterCard requested to initiate Euro Master Visa (EMV) Chip acquiring functionality for Bank's ATMs and ensure that all the ATMs for the Banks are EMV Chip enabled by the given deadline of 16 October 2015. EMV chip technology can provide a more secure alternative to non-chip technology for reducing fraudulent transactions.

Chip liability shift is a counterfeited magnetic stripe card is used at any of the ATMs in the aforementioned countries of South Asia and if the ATM is not EMV Chip enabled then the chargeback liability shifts to the acquirer.

Despite the MasterCard's notification on liability shift due in October 2015, the Bank had not identified the risk in any of the Bank's risk grids to date. Currently the project is pending completion and the Bank is opened up for the liability on fraudulent transactions.

4.4 Matters of Contentious Nature

The following observations were made.

(a) Smelting of Unredeemed Gold Jewellery

The following observations were made.

- (i) According to the Office Instruction Circular No. 46/2010 on pawning advance services dated 15 January 2010 as amended by Circular No. 21 of 18 June 2014

Branches have been instructed to transfer the gold jewellery remaining unsold after presenting to an auction to an account named Gold in Hand. Accordingly, the gold pawning loan value the Branches had transferred to the Gold in Hand Account as at 30 November 2014 amounted to Rs.19,965,835,972.

- (ii) Out of the gold transferred, 112.62 kilo grams valued at Rs.570.38 million had been smelted and the weight and value of gold produced from smelting amounted to 111.68 kilo grams and Rs.451.98 million respectively. Thus indicating a reduction of 940 grams of gold valued at Rs.118.40 million in smelting.
- (iii) At the physical verification on 30 December 2015 at the Head Office main vault a shortage of 37.19 grams of the smelt gold was observed. According to Chairman's reply, "Gold weight of smelted gold bars stated in the stock book has been recorded according to the figures shown in weighing machines used by the service provider. Physical verification has been done by using the newly purchased weighing machine of the Ran Surekum Naya Sewa Unit, Consumer Product Management Department after calibration made by Measurement Units, Standards and Services Department. The weight resulted during the physical verification was 37.19 grams lower than the recorded weight using the weighing machine of the service provider".

(b) Settlement of outstanding Import Bill transactions of Government of Sri Lanka

The Bank of Ceylon gives special rates to its customers who apply for buying American Dollars 5,000 or more. These special rates are decided by the Bank according to American Dollar and Rupee exchange rate in the market at the time of customer application. Rates are decided by adding some cents to the market selling rate (eg. 10 to 25 cents). However, the Bank had earned an unjustifiable profit of Rs. 268,122,303 which is beyond the profit that would have been earned from best customers applying special rates. In view of the above, the Government of Sri Lanka being the customer who contributes more than 40 per cent of the Bank's business and the owner of the bank should get the best rates from Bank of Ceylon for their transactions which are amounted to millions of dollars. However the above transaction of the Bank will make greater concerns over the inappropriate absorption of public money as profit.

4.5 Treasury Operations

The following observations were made.

(a) Non-compliance with the Provisions in Paragraph 2.2.2 in Public Debt Department Circular No. SSSS/04/2007 of 28 September 2007.

As a Dealer Direct Participant, the Bank of Ceylon had failed to record 111 Re-purchase (REPO) transactions valued at Rs.58,686,089,500 promptly and accurately in Lanka Secure ownership to show the change in legal ownership of the securities attached for such transactions contrary to the regulations imposed by the Central Bank of Sri Lanka. Even though the REPO transactions cannot be back-valued practically, the Treasury

Division had accommodated this facility to its customers, exposing the Bank to a risk of “non-recording transaction charge on the Dealer Direct Participant”. The possible surcharge may amount to Rs.586,860,895 (1 per cent of the unrecorded transaction value). Since such transactions are unrecorded in the Lanka Secure, any transactions related to the unrecorded period can be treated as unsecured money market transactions.

(b) Foreign Exchange Position Reporting to the Central Bank of Sri Lanka

 The following observations were made.

- i) At present, the Bank calculates its foreign exchange day end position based on the figures obtained over the phone from business units. Dealers attached to the International Fund Management Desk covers such positions at the end of the day in order to adhere with the Central Bank Net Open Position limit. However, during the audit it was observed that on the beginning of the following day the Bank recalculate its foreign exchange exposure based on the foreign currency balance sheet by checking foreign exchange assets and liabilities. In some instances it was observed that foreign exchange assets and liabilities mismatch carries US Dollar millions worth of deviations from manually calculated figures on previous day. Since there is no alternative available, the Bank recognizes the foreign exchange position derived from Integrated Comprehensive Banking System (ICBS). According to the above observation it is revealed that the senior management of the Treasury Division as the responsible authority for managing its foreign exchange exposure to minimize the market risk thereon and adhering to regulatory reporting procedure, has failed to identify, recognize and report its actual foreign exchange position accurately. Therefore, the Bank embraces a huge market risk and risk of non-compliance.

Further, the management has failed to explain the following differences which observed during the sample Audit (US Dollars Only).

Date	Day end Position as per the Manual calculation USD	Day end position as per the ICBS USD	Difference USD
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01/10/2015	2,597,324	(144,767)	2,452,557
02/10/2015	(5,841,421)	37,587	(5,803,834)
07/10/2015	(2,830,285)	585,004	(2,245,281)
08/10/2015	(1,678,006)	5,506,184	3,828,178
09/10/2015	(1,261,640)	3,926,988	2,665,348
12/10/2015	(1,933,534)	175,249	(1,758,285)
14/10/2015	1,041,757	15,664	1,026,093
16/10/2015	(653,363)	(1,620,253)	(2,273,616)
21/10/2015	2,438,469	3,639,165	6,077,634
22/10/2015	3,861,934	1,782,516	5,644,450

28/10/2015	(370,387)	1,605,609	1,235,222
29/10/2015	(3,136,407)	808,710	(2,327,697)
30/10/2015	46,506	(2,574,982)	(2,528,476)

- ii) Foreign exchange exposure calculation and reporting to Central Bank should be carried out by an officer independent of dealing activities in order to strengthen the internal control. However, it is observed that this function is still continuing by an Assistant Dealer attached to dealing room.

(c) Non-compliance with direction on Repurchase and Reverse Repurchase agreement dated 02/05/2002

As per the above direction of Central Bank of Sri Lanka (CBSL), adequate securities should be allocated for the borrowings against Repo. However, the following transactions had not been allocated the required amount of securities to cover the market value of the transactions and the hair cut violating above direction.

Deal Date	Deal No.	Counterparty	Capital + Accrued Interest Rs.	Market value of Securities Rs.	Under Allocation Rs.
Not Received	Not Received	Housing Development Fund	61,064,178	56,803,521	4,260,657
Not Received	Not Received	Post Office Security Fund	43,937,552	41,895,490	2,042,062

(d) Central Bank of Sri Lanka (CBSL) Treasury Bond Issue on 27 February 2015

The following observations were made.

- (i) Details of bids submitted by the Primary Dealers Unit of the Bank of Ceylon (BoC) on the Treasury Bond auction held on 27 February 2015 in respect of Treasury Bonds with 30 years of maturity period are depicted below.

	Customer	Rate (%)	Face Value Rs. Million	CBSL Accepted Amount Rs. Million
1	Kaluthara Bodhi Trust	9.35	8	8
2	Ceylinco Insurance Life	10.25	500	500
3	Perpetual Treasuries Ltd	12.50	3,000	3,000

4	Perpetual Treasuries Ltd	12.75	5,000	Unsuccessful
5	Perpetual Treasuries Ltd	13.00	5,000	Unsuccessful
	Total		13,508	

- (ii) Bank of Ceylon has been requested to submit a bid for and on behalf of another Primary Dealer at a Treasury bond auction for the first time. i.e. Treasury Bond auction held on 27 February 2015 and on behalf of Perpetual Treasuries Ltd.
- (iii) The Treasury Division of the Bank does not obtain Know Your Customer (KYC) from reputed banks and Primary Dealers separately.
The following were found in the audit test checks subsequent to the previous COPE meetings.
- The Corporate Branch of the Bank maintains two current accounts in the name of Perpetual Treasuries Ltd. and the Bank had obtained KYC forms for these accounts with regard to checking of due diligence.
 - The Bank had entered into Reverse Repo Transactions amounting to Rs. 106 billion during 2014 and 2015 and it was further revealed that the Bank had signed a “Master Repo Agreement” with this company to cover those transactions.
- (iv) According to the Section No. 6 of Bank of Ceylon Treasury Operations Manual, Primary Dealer unit should not process applications without verification of funds, signatures and other vital data. They also should adhere to the KYC guidelines especially in the cash transactions. But contrary to the above instructions Primary Dealer unit was aware that the Perpetual Treasuries Ltd did not have sufficient fund to settle the bids on an event of success.

Detailed audit trails after the previous COPE meetings revealed the following.

Bank of Ceylon had no written procedure for primary bidding on account of other banks, major reputed corporations and Primary Dealers. Procedure to be followed in this type of bidding was introduced by the Board Memorandum dated 07 September 2015 after the controversial Bond issue held on 27 February 2015, under the “Set procedure for Primary Auction Bidding, SWAP transactions against Government Securities and Investment through Reverse Repo/Government Securities.

It was further observed that the fund checking methodology for Direct Primary Bidders has been introduced in the Section 3 of the above Board Memo only on 07 September 2015.

- (v) The second transaction was a SWAP transaction where the Bank of Ceylon has bought Rs. 2.3 Billion worth of Bonds from Perpetual Treasuries on 2 March 2015 and sold the same Bond on 6 March 2015 at the rates of 12.50 per cent and 12.4950 per cent respectively. The committee further observed that Perpetual Treasuries Ltd. has first settled Rs. 1 Billion worth of Bonds at 3.26 p.m. on 2 March 2015. According to the Central Bank, Perpetual Treasuries Ltd. has received another Rs. 2

billion worth of Bonds from the auction. Therefore, they have had sufficient securities to settle the transaction agreed on the SWAP basis. (To sell the Bond to BOC) Thereafter, they have settled the outstanding balance of Rs. 2 billion (purchased from BOC through auction) to the Bank of Ceylon on the same day.

Subsequently, Perpetual Treasuries Ltd. has purchased the Bonds worth Rs. 2.3 billion from the Bank of Ceylon concluding the SWAP transaction. the Bank of Ceylon has realized a gain of Rs. 3.9 million out of this transaction.

- (vi) There is no documentary evidence for the time extended up to 11.10 a.m. for the Central Bank of Sri Lanka Bid auction held on 27 February 2015. It has been agreed by telephone communication. According to the Central Bank bidding print out, the auction time had been extended until 11.10 a.m.
- (vii) According to the Primary Dealer (Perpetual Treasuries Ltd.) it was stated that they have bid on behalf of Insurance Company. However, they could not provide documentary evidence to prove this statement. It was also evident that these Bonds purchased by the Perpetual Treasuries Ltd. have never been sold to Insurance Company in the secondary market.

4.6 Operating Inefficiencies

Operations of Overseas Branches

The following observations were made.

(a) Bank of Ceylon (UK) Limited

Bank of Ceylon (UK) Limited is a fully owned Subsidiary of the Bank. The Cost of investment was Rs. 2,684 million as at 31 December 2015. However, the profitability of the Subsidiary had continuously been deteriorated as follows.

Period	Net Profit / (Loss) After Tax Amount in GBP	Net Profit / (Loss) After Tax Amount in Rs.
8 months period ended 31.12.2010	(89,272)	(15,373,531)
Year ended 31.12.2011	(414,108)	(73,541,440)
Year ended 31.12.2012	(221,000)	(45,459,700)
Year ended 31.12.2013	(422,000)	(91,092,920)
Year ended 31.12.2014	(596,000)	(122,031,000)
Year ended 31.12.2015	(312,293)	(66,697,089)

Due to increasing of losses, the Subsidiary was not in a position to pay dividends since its inception in 2010.

(b) Seychelles Branch of the Bank

Deposits

As at 31 December 2015 the total number of customer accounts maintained at the Seychelles Branch was 811. Out of total accounts, 176 accounts were maintaining at zero balance and it represents 22 per cent of the total number of accounts. Details are given below.

Description of Accounts	Total Number of Accounts	Number of Zero Balance Accounts
Savings Accounts	598	141
Current Accounts	210	35
Fixed Deposits	03	-
Total	811	176

i) Cost of Capital of Issued Funds

The Bank had granted USD 1.5 million as a loan facility to Seychelles Branch on 25 September 2015 at a rate of 6 months London Interbank Offered Rate (LIBOR) plus 4 per cent. However, it was assessed that the Bank's Weighted Average Cost of Capital of US Dollars at the same date was 4.83 per cent.

According to the Chairman of the Bank, "This was not a business loan on commercial basis and Seychelles Branch lends at rates between 8-12 per cent and the Bank had overall earning on USD funds lent to that Branch."

ii) Deposits from Customers

During the review of deposits, it was observed that ten major deposits customers amounted to 73 per cent of the total deposits of the Branch as at 31 December 2015. This indicates that the Branch was more dependent on very limited depositors and exposed to high liquidity risk. Hence, it was observed that this situation would adversely affect the going concern of the Branch.

5 Systems and Controls

Deficiencies in systems and controls observed during the course of audit were brought to the notice of the Bank by my detailed reports issued to the Chairman of the Bank. Special attention is needed in respect of the following areas of control.

- (a) Loan Administration
 - Non Performing Advance Ratio
 - Highest Non Performing Customers and Branches
 - Written Off Loans

- (b) Primary Dealer Unit - Non-compliance
 - Foreign Exchange Positions

- (c) Overseas Branch
 - Loss making foreign branches
 - Depending on few depositors