

PART II

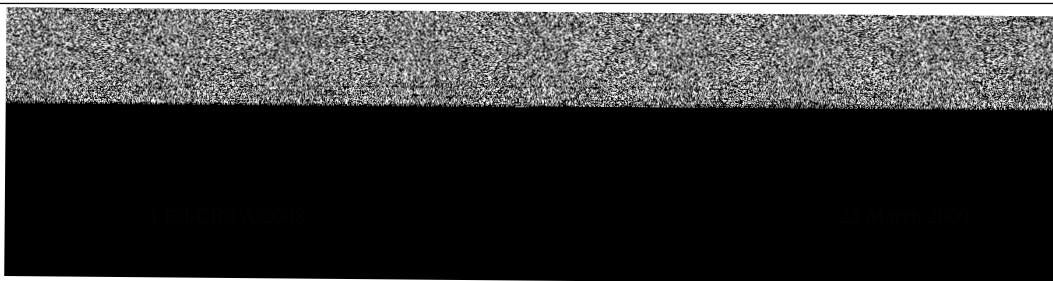
PART II

ACCOUNTS AND OPERATIONS OF THE CENTRAL BANK OF SRI LANKA

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1. ACCOUNTS AND FINANCE



REPORT OF THE AUDITOR GENERAL

The audit of the financial statements of the Central Bank of Sri Lanka (CBSL) as at 31 December 2008, which comprise the Balance Sheet as at that date, and the Income Statements, Statements of Changes in Equity and Cash Flow Statement for the year then ended, and summary of significant accounting policies and other explanatory notes (Nos.1 to 24) to the financial statements was carried out under my direction in pursuance of provisions in Article 154(1) of the Constitution of the Democratic Socialist Republic of Sri Lanka read in conjunction with Section 13 of the Finance Act No.38 of 1971 and the Section 42(2) of the Monetary Law Act, (Chapter 422). An audit of the financial statements of CBSL with regard to the compliance of the International Financial Reporting Standards had been carried out by a firm of Chartered Accountants in public practice appointed by the Monetary Board of the CBSL.

Management's Responsibility for the Financial Statements

Management is responsible for preparation and fair presentation of these financial statements in accordance with the Sri Lanka Accounting Standards. This responsibility includes: designing, implementing and maintaining internal controls relevant to the preparation and fair presentation of financial statements that are free from material misstatements, whether due to fraud or error, selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Scope of Audit and Basis of Opinion

My responsibility is to express an opinion on these financial statements based on my audit. The audit was conducted in accordance with Sri Lanka Auditing Standards, which require that the audit shall be planned and performed to obtain reasonable assurance as to whether the financial statements are free from material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the said financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the management, as well as evaluating the overall presentation of financial statements. I have obtained all the information and explanations which to the best of my knowledge and belief were necessary for the purpose of my audit. I therefore believe that my audit provides a reasonable basis for my opinion.

Opinion

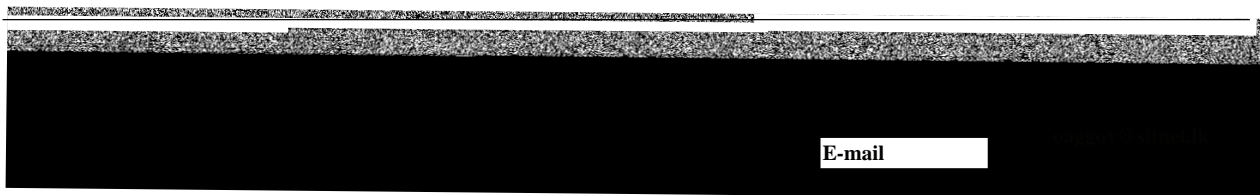
In my opinion, so far as appears from my examination, the Bank had maintained proper accounting records for the year ended 31 December 2008 and the financial statements give a true and fair view of the Bank's state of affairs as at 31 December 2008 and its profits and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

Report to Parliament

My report to Parliament in pursuance of provisions in Article 154(6) of the Constitution will be tabled in due course.



S. Swarnajothi
Auditor General




E-mail

CENTRAL BANK OF SRI LANKA**Balance Sheet
As at 31 December**

	Note	2008 Rs. '000	2007 Rs. '000
Assets			
Foreign Currency Financial Assets			
Cash & Cash Equivalents	1	167,338,807	160,051,979
Financial Assets:			
- Securities at Fair value through Profit or Loss	2	50,381,845	113,583,131
- Available for Sale Investments	2	41,733,314	79,541,928
IMF Related Assets	3	72,399,875	71,899,462
Other Foreign Receivables		1,427,899	767,873
Total Foreign Currency Financial Assets		333,281,740	425,844,373
Local Currency Financial Assets			
Investment Portfolio - Sri Lanka Government Securities		159,771,674	43,612,184
Advances to Government	4	76,307,700	60,679,200
Loans to Other Institutions	5	1,577,301	2,093,651
Other Local Receivables		659,770	706,767
Investments in Financial and Other Institutions	6	50,729	50,135
Other Assets		1,364,690	1,230,687
Total Local Currency Financial Assets		239,731,864	108,372,624
Total Financial Assets		573,013,604	534,216,997
Foreign Currency Non-Financial Assets			
Securities Denominated in Gold		10,427,432	13,991,886
Local Currency Non-Financial Assets			
Inventories	7	1,961,687	1,665,348
Gold Inventory being refined		-	59,766
Sundry Assets		2,405,922	2,155,045
Property, Plant and Equipment	8	9,242,988	9,354,648
Intangible Assets	9	15,717	953
Total Local Currency Non-Financial Assets		24,053,746	27,227,646
Total Assets		597,067,350	561,444,643
Liabilities and Equity			
Foreign Currency Financial Liabilities			
Amounts Payable to Banks and Financial Institutions	10	336,091	6,730,522
Amounts Payable to Asian Clearing Union		91,354,909	48,454,327
IMF Related Liabilities	11	95,133,658	102,291,389
Other Foreign Payables		1,517,077	1,615,652
Total Foreign Currency Financial Liabilities		188,341,735	159,091,890
Local Currency Financial Liabilities			
Deposits by Banks and Financial Institutions	12	82,311,214	91,053,024
Balances with Government and Governmental Entities	13	1,245,624	1,416,075
Securities Sold Under Agreements to Repurchase		13,743,000	18,000
Balances with Employee Benefit Plans	14	1,155,061	2,250,167
Other Payables		1,664,352	1,923,545
Total Local Currency Financial Liabilities		100,119,251	96,660,811
Total Financial Liabilities		288,460,986	255,752,701
Other Liabilities			
Currency in Circulation		186,098,914	173,363,722
Deferred Grants		-	68
Pension and Other Post Employment Benefit Plans		1,026,698	324,182
Miscellaneous Liabilities and Accruals		531,960	614,603
Total Other Liabilities		187,657,572	174,302,575
Total Liabilities		476,118,558	430,055,276
Equity			
Capital Funds	15	25,000,000	15,000
Reserves	15	95,948,792	131,374,367
Total Equity		120,948,792	131,389,367
Total Liabilities and Equity		597,067,350	561,444,643

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


Ajith Nivard Cabraal - Governor


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

CENTRAL BANK OF SRI LANKA

Income Statement For The Year Ended 31 December

	Note	2008 Rs. '000	2007 Rs. '000
Operating Income:			
Income from Foreign Currency Financial Assets			
Interest Income	16	11,129,190	13,240,762
Gain /(Loss) from Unrealized Price Revaluations		2,211,883	4,413,887
Gain /(Loss) Realized from Price Changes		6,648,280	2,189,134
Total Income from Foreign Currency Financial Assets		19,989,353	19,843,783
Expenses on Foreign Currency Financial Liabilities			
Interest Expense	17	(1,301,552)	(2,226,270)
Total Expenses on Foreign Currency Financial Liabilities		(1,301,552)	(2,226,270)
Net Foreign Exchange Revaluation Gain / (Loss)		(22,810,925)	8,812,401
Foreign Currency Investment Income / (Loss)		(4,123,124)	26,429,914
Income from Local Currency Financial Assets			
Interest Income	16	7,043,031	9,516,837
Interest Expense	17	(511,709)	(551,596)
Total Income from Local Currency Financial Assets		6,531,322	8,965,241
Other Income	18	454,250	421,396
Total Net Operating Income / (Loss)		2,862,448	35,816,551
Operating Expenses:			
Personnel Expenses			
- Salaries & wages	19	(1,718,302)	(1,591,667)
- Defined Contribution plan cost	19	(215,066)	(187,834)
- Additional contribution to Post Employment Benefit Plans	19	(1,333,944)	(1,671,606)
		(3,267,312)	(3,451,107)
Depreciation & Amortization		(302,977)	(270,040)
Cost of Inventory		(926,586)	(1,052,160)
Administration Expenses	20	(1,472,257)	(1,172,965)
Bad & Doubtful Debts and Net Sundry Write Offs		-	(52)
Total Operating Expenses		(5,969,132)	(5,946,324)
Profit /(Loss) Before Income Tax		(3,106,684)	29,870,227
Income Tax		(1,937,740)	(1,044,842)
Net Profit /(Loss) for the Year		(5,044,424)	28,825,385

CENTRAL BANK OF SRI LANKA

Cash Flow Statement For The Year Ended 31 December

	Note	2008 Rs. '000	2007 Rs. '000
Cash Flow from Operating Activities:			
Source:			
Interest Received - Foreign Currency		11,970,696	13,091,488
Interest Received - Local Currency - Others		688,187	380,567
Liquidity Management and Trading Income		6,648,280	2,189,134
Realized Exchange Gain / (loss)		(269,850)	89,345
Other Income Received		454,182	348,438
		<u>19,491,495</u>	<u>16,098,972</u>
Disbursements:			
Interest Paid - Foreign Currency		1,447,241	2,234,299
Interest Paid - Local Currency		507,687	552,055
Payments to Employees		3,608,251	1,782,510
Payments to Suppliers		(23,623,338)	3,583,244
Income Tax Paid		28,611,636	663,653
		<u>10,551,477</u>	<u>8,815,761</u>
Net Cash Flow from Operating Activities	21	<u>8,940,018</u>	<u>7,283,211</u>
Cash Flows from Investing Activities:			
Source:			
Net (Increase) / Decrease in Other Local Currency Financial Assets		(304,851)	(822,394)
Principal recoveries from the Loans and Advances to Other Institutions		252,307	393,795
Disposal / Redemption of Investments in Financial and Other Institutions		(594)	(4,950)
Sale of Property, Plant and Equipment		-	-
Income on Investments in Financial and Other Institutions		-	28,591
Net Increase in Securities Purchased under Agreement to Re-sell		13,725,000	(544,000)
		<u>13,671,863</u>	<u>(948,958)</u>
Disbursements:			
Net Increase / (Decrease) in Foreign Currency Securities		(86,444,960)	6,186,179
Net Increase / (Decrease) in Other Foreign Currency Financial Assets		(541,626)	587,989
Net Increase / (Decrease) in Other Foreign Currency Financial Liabilities		(33,914,788)	(12,345,621)
Net Increase / (Decrease) in Other Local Deposits & Payables		(4,861)	4,409
Purchase of Property, Plant and Equipment net of Grants		(2,269,492)	221,447
Net Increase/(Decrease) in Gold Inventory		206,080	(181,599)
		<u>(122,969,647)</u>	<u>(5,527,195)</u>
Net Cash Flow from Investing Activities		<u>136,641,510</u>	<u>4,578,237</u>
Cash Flows from Financing Activities:			
Source:			
Issue of Circulating Currency		219,507,915	209,034,025
Withdrawal of Circulating Currency		(206,772,722)	(192,909,909)
Net Issue of Circulating Currency		12,735,193	16,124,116
Less:			
Net Issue / (Withdrawals) of Circulation Currency on Government Transactions	22	125,419,584	(21,422,909)
Net Issue / (Withdrawals) of Circulation Currency on Bank and Financial Institutions Transactions	23	8,741,810	(8,564,417)
Net Issue / (Withdrawals) of Circulating Currency		<u>134,161,394</u>	<u>(29,987,326)</u>
		<u>(121,426,201)</u>	<u>46,111,442</u>
Disbursements:			
Repayment of Foreign Currency Term Liabilities		8,313,981	605,092
Payments to other funds		-	15,090
Payments of Surplus to Government		8,000,000	4,000,000
		<u>16,313,981</u>	<u>4,620,182</u>
Net Cash Flow from Financing Activities		<u>(137,740,182)</u>	<u>41,491,260</u>
Net Increase in Cash and Cash Equivalents		7,841,345	53,352,706
Exchange Rate Effect on Cash and Cash Equivalents		(554,517)	1,097,587
Cash and Cash Equivalent at the Beginning of the Year		160,051,979	105,601,686
Cash and Cash Equivalent at 31 December 2008	24	<u>167,338,807</u>	<u>160,051,979</u>

CENTRAL BANK OF SRI LANKA

Statement of Movements in Equity as at 31 December 2008

	Contributed Capital Rs. '000	Reserves Appropriated as Capital Rs. '000	Revaluation Reserve Rs. '000	Other Reserves Rs. '000	Accumulated Profits Rs. '000	Total Rs. '000
As At 1 January 2007	15,000	-	473,057	90,712,965	12,148,493	103,349,515
Net Profit	-	-	-	-	28,825,385	28,825,385
Transfer to RTGS Sinking Fund	-	-	-	46,341	(46,341)	-
Transfer to General Reserve	-	-	-	1,478,488	(1,478,488)	-
Transfer to CBSL Specific Reserve	-	-	-	100,914	(100,664)	250
Gain or Loss on Revaluation	-	-	2,233,010	-	-	2,233,010
Transfer of Profit to Govt	-	-	-	-	(4,000,000)	(4,000,000)
Transfer of Sales Proceed of Kandy Property	-	-	-	-	(15,090)	(15,090)
Transfer of Net Foreign Exchange Revaluation Gain	-	-	-	8,812,401	(8,812,401)	-
Net Fair Value / (Loss) on Available for Sale Securities	-	-	-	996,817	-	996,817
Spot position Effect	-	-	-	-	(520)	(520)
As At 1 January 2008	15,000	-	2,706,067	102,147,926	26,520,374	131,389,366
Net Profit (Loss)	-	-	-	-	(5,044,424)	(5,044,424)
Transfer to RTGS Sinking Fund	-	-	-	63,294	(63,294)	-
Transfer to General Reserve	-	-	-	11,722,139	(11,722,139)	-
Transfer of Net Foreign Exchange Revaluation Loss	-	-	-	(22,810,925)	22,810,925	-
Transfer to CBSL Specific Reserve	-	-	-	150,377	(150,377)	-
Net Fair Value / (Loss) on Available for Sale Securities	-	-	-	2,603,850	-	2,603,850
Transfer of Funds from General Reserve to Reserve Appropriated as Capital	-	24,985,000	-	(24,985,000)	-	-
Transfer of Profit to Government	-	-	-	-	(8,000,000)	(8,000,000)
As At 31 December 2008	15,000	24,985,000	2,706,067	68,891,661	24,351,065	120,948,792

CENTRAL BANK OF SRI LANKA

Notes to be read as part of the Financial Statements

	2008 Rs. '000	2007 Rs. '000
1. Cash & Cash Equivalents		
Balances with Overseas Banks	45,683,515	6,831,527
Time Deposits with Overseas Banks	39,017,982	130,280,290
Time Deposits contracted In	-	4,327,401
Deposits Under Repurchase Agreements	82,637,310	18,612,761
	<u>167,338,807</u>	<u>160,051,979</u>
2. Financial Assets		
Securities at Fair Value through Profit or Loss	50,381,845	113,583,131
Available for Sale Investments	41,733,314	79,541,928
Total Financial Assets	<u>92,115,159</u>	<u>193,125,059</u>
3. IMF Related Assets		
Holding in Special Drawing Rights	220,853	740,172
IMF Quota	72,041,564	71,023,774
Deposit with IMF	137,458	135,516
Total IMF Related Assets	<u>72,399,875</u>	<u>71,899,462</u>
4. Advances to Government		
Revolving Credit	76,307,700	60,679,200
Total Advances to Government	<u>76,307,700</u>	<u>60,679,200</u>
5. Loans to Other Institutions		
Capital Outstanding		
Related Parties	48,058	50,670
Others	2,148,718	2,152,116
Receivable under Susahana Tsunami Loan Scheme		
Related Parties	821,613	1,046,496
Others	737,404	1,022,861
Interest Receivable	4,220,236	4,218,134
Gross Receivable	7,976,029	8,490,277
Less: Allowance for Doubtful Receivables	(2,178,492)	(2,178,492)
Suspended Interest	(4,220,236)	(4,218,135)
Net Receivable	<u>1,577,301</u>	<u>2,093,650</u>
6. Investments in Financial and Other Institutions		
Credit Information Bureau Ltd	15,479	12,135
Lanka Clear (Pvt) Ltd	29,500	29,500
Fitch Ratings Lanka Ltd	3,500	3,500
Lanka Financial Services Bureau Limited	2,250	5,000
Total Investments in Financial and Other Institutions	<u>50,729</u>	<u>50,135</u>
7. Inventories		
Notes for Circulation	1,538,974	1,155,948
Coins for Circulation	441,512	497,949
Coins in Transit	7,739	41,155
	<u>1,988,226</u>	<u>1,695,052</u>
Less: Allowance for Slow Moving Items	<u>(55,300)</u>	<u>(55,300)</u>
	1,932,926	1,639,752
Stationery and Sundry Inventory	28,761	25,596
Total Inventories at Lower of Cost and Net Realizable Value	<u>1,961,687</u>	<u>1,665,348</u>

8. Properties, Plant and Equipment

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

	2008 Rs. '000	2007 Rs. '000
9. Intangible Assets		
Computer Software		
Cost:		
As at 1 January	464,420	463,149
Additions	20,039	1,271
Disposals	-	-
As at 31 December	484,459	464,420
Amortisation and Impairment:		
As at 1 January	463,467	463,149
Amortisation Charge for the year	5,275	318
As at 31 December	468,742	463,467
Net Book Value:		
As at 1 January	953	-
As at 31 December	15,717	953
10. Amounts Payable to Banks and Financial Institutions		
Payable to Foreign Banks	-	6,246,208
Payable to other Foreign Financial Institutions	336,091	484,314
Total Amount Payable to Banks and Financial Institutions	336,091	6,730,522
11. IMF Related Liabilities		
Interest Bearing Loans – Non Current	7,534,695	18,809,059
Interest Bearing Loans – Current	11,543,903	8,501,764
Allocation of Special Drawing Rights	12,349,883	12,175,406
Other Amounts Payable to IMF	39,987,545	38,417,617
Quota Liability	23,717,632	24,387,543
	87,598,963	83,482,330
Total IMF Related Liabilities	95,133,658	102,291,389
12. Deposits by Banks and Financial Institutions		
Deposits by Banks:		
- Related Parties	33,347,603	38,250,751
- Others	48,960,685	52,795,434
	82,308,288	91,046,185
Deposits by Financial Institutions		
- Related Parties	91	64
- Others	2,836	6,775
	2,926	6,839
Less: Advances under Intra-day Liquidity Facility	-	-
Total Deposits by Banks and Other Financial Institutions	82,311,214	91,053,024

	2008 Rs. '000	2007 Rs. '000
13. Balances with Government and Governmental Entities - Related Parties		
Government Deposits	341,343	642,135
Government Agencies and Funds	904,281	773,940
Total Balances with Government and Governmental Entities	1,245,624	1,416,075
14. Balances with Employee Benefit Plans		
Employee Provident Fund – Related Party	2,563	713
Employee Retirement Pension Scheme – Related Party	(482,438)	437,867
Widows' /Widowers' & Orphans' Pension Schemes'– Related Party	704,166	829,216
Payable in respect of Gratuity	39,337	46,488
Payable in respect of Medical Benefit Scheme	891,433	935,883
Total Other Deposits	1,155,061	2,250,167
15. Capital & Reserves		
Capital	15,000	15,000
Reserves Appropriated as Capital	24,985,000	-
Capital contribution Account	-	577,859
Fixed assets Revaluation Account	2,706,067	2,706,067
Market Valuation Reserve-securities Available for sale	1,822,401	(781,449)
Profit / (Loss) for the year	(5,044,424)	28,825,384
International Reserve Revaluation	38,651,679	61,422,435
Other Reserves	57,813,069	38,624,071
	120,948,792	131,389,367
16 Interest Income from Financial Assets		
Interest Income from Foreign Currency Financial Assets		
Cash & Cash Equivalents	4,670,088	5,956,825
Financial Assets	6,334,568	7,086,382
IMF Related Assets	124,534	169,872
Other Foreign Receivables	-	27,683
Total Interest Income from Foreign Currency Financial Assets	11,129,190	13,240,762
Interest Income from Local Currency Financial Assets		
Investment Portfolio – Sri Lanka Government Securities–	6,538,858	9,207,485
Other Loans and Advances	504,173	309,352
Total Net Interest Income from Local Currency Financial Assets	7,043,031	9,516,837
Total Interest Income from Financial Assets	18,172,221	22,757,599
17. Interest Expense on Financial Liabilities		
Interest Expense on Foreign Currency Financial Liabilities		
Amount Payable to Asian Clearing Union	869,784	1,330,404
IMF Related Liabilities	428,110	828,181
Securities Sold Under Agreements to Repurchase	-	67,685
Other Foreign Payable	3,658	-
Total Interest Expense on Foreign Currency Financial Liabilities	1,301,552	2,226,270
Interest Expense on Local Currency Financial Liabilities		
Securities Sold Under Agreements to Repurchase	511,709	551,596
Total Interest Expense on Local Currency Financial Liabilities	511,709	551,596
Total Interest Expense on Financial Liabilities	1,813,261	2,777,866

	2008 Rs. '000	2007 Rs. '000
18. Other Income		
Dividend Income - Related Parties	9,048	12,648
- Others	-	394
Gain on Disposal of Property, Plant & Equipment	1,708	567
Gain on disposal of Investments in Financial and other Institutions	308	(12)
Amortization of Deferred Grant	68	60,007
Miscellaneous Income	443,119	347,792
Total Other Income	454,250	421,396
19. Personnel Expenses		
Wages and salaries including PAYE paid by the employer	1,718,302	1,591,667
Post Employee Defined Benefit Plan Costs	1,333,944	1,671,606
Defined Contribution Plan Costs	215,066	187,834
Total Personnel Expenses	3,267,312	3,451,107
20. Administration Expenses		
Repairs and Maintenance	441,637	341,234
Information	77,242	78,564
Operational Travel	48,532	20,099
Rental Expenses	1,217	1,239
Printing	23,830	23,982
Audit Fees	8,688	9,040
Remuneration to members of the Monetary Board	383	389
Interest Expense on CBSL Provident Fund	468,165	453,125
Miscellaneous	402,563	245,293
Total Other Operating Expenses	1,472,257	1,172,965
21. Reconciliation of Operating Profit with Operating Cash Flow		
Reported Net Profit from Operating Activities	(5,044,424)	28,825,385
Add (Subtract) Non-Cash Items		
Depreciation	302,977	270,040
Interest Received – Local Currency – Investment Portfolio	(6,538,858)	(9,131,665)
Provision for Post Employee Defined Benefits Plans	4,682,839	-
Gross Unrealised Foreign Exchange (Gain) Loss	22,541,075	(8,723,055)
Other Provision	21,329,329	1,943,189
Deferred Grants	(68)	(59,917)
Add (Subtract) Movements in Other Working Capital Items		
(Increase) / Decrease in Inventories	(296,339)	602,189
(Increase) / Decrease in Interest Receivable	1,025,519	(141,746)
Increase / (Decrease) in Miscellaneous Liabilities	(26,755,479)	(2,304,419)
Increase / (Decrease) in Interest Payable	(141,667)	(36,171)
Increase / (Decrease) in Other Receivable	46,997	450,759
Add (Subtract) Investing and Financing Activities		
Income from Investments	-	15,550
Dividend Received	-	(13,041)
Net Unrealized Market Value Changes	(2,211,883)	(4,413,887)
Net Cash Flow From Operating Activities	8,940,018	7,283,211
Add (Subtract) Investing and Financing Activities		
Income from Investments	-	15,550
Dividend Received	-	(13,041)
Net Unrealized Market Value Changes	(2,211,883)	(4,413,887)
Net Cash Flow From Operating Activities	8,940,018	7,283,211

	2008 Rs. '000	2007 Rs. '000
22. Issues / (Withdrawals) of Circulation Currency on Government Transactions		
Maturity of Government of Sri Lanka Securities Portfolio	-	(233,522,233)
Purchases of Government of Sri Lanka Securities for Investment Portfolio	114,186,270	209,516,796
Interest Received – Local Currency – Investment Portfolio	(4,565,637)	(9,021,548)
Increase /(Decrease) in Loans and Advances to GOSL	15,253,700	11,663,800
(Increase) /Decrease Balances with Government and Government Entities	545,251	(59,724)
	<u>125,419,584</u>	<u>(21,422,909)</u>
23. Net Issues / (Withdrawals) or Circulation Currency on Bank and Financial Institutions Transactions		
(Increase) /Decrease in Deposits by Banks and Financial Institutions	8,741,810	(8,564,417)
	<u>8,741,810</u>	<u>(8,564,417)</u>
24. Closing Cash & Cash Equivalents		
Foreign Currency Assets		
Cash Balances with Other Foreign Banks	167,338,807	160,051,979
Closing Cash & Cash Equivalents	<u>167,338,807</u>	<u>160,051,979</u>

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 Entities 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 6th March 2009.

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

These financial statements of Central Bank of Sri Lanka for the year ended 31 December 2008 have been prepared in accordance with International Financial Reporting Standard (IFRS). The financial statements prepared in accordance with the Monetary Law Act (MLA) are audited by the Auditor General and gazetted as required by the law. Due to certain requirements in the IFRS, the classifications, and hence the numbers, in the gazetted financial statements, would be different from those in these financial statements.

Currency of Presentation

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

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.

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

Certain new standards, amendments and interpretations to existing standards have been published that are applicable for the Bank's accounting periods beginning on or after 1 January 2009 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 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:

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

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

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.

Gold

Section 67 (1) of the Monetary Law Act which specifies the composition of the International Reserve indicates that gold may be held by the

CBSL as part of this Reserve. Hence, CBSL held Rs. 10,427,431 in gold as part of its International Reserves as at 31/12/2008. As this gold is part of the International Reserve and not used as a commodity which is traded during the normal course of business, gold is fair valued and the gains or losses are transferred to the income statement. Prior to appropriation of profits, the unrealised gains or losses from gold are transferred to the relevant reserve account.

Derivative Instruments

The Bank's involvement in derivative instruments is mainly in forward foreign exchange contracts. Such derivative financial instruments are stated at fair value. The fair value of forward exchange contracts is calculated by reference to current forward exchange rates for contracts with similar maturity profiles. All derivative instruments in a gain or loss position, if any, are reported within the balance of foreign currency trading or available for sale securities in the Balance Sheet.

International Monetary Fund (IMF) Related Balances

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

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

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

Cash and Cash Equivalents

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

As a part of local currency activities CBSL generates certain income and incurs expenses, which do not involve in movement of cash. Those activities result in certain assets and liabilities and mainly comprise of the transactions with GOSL and transactions with domestic banks and financial institutions. Transactions with GOSL include the purchase of un-subscribed portions of Treasury bills and bonds

that are issued by the Government by the Bank as a monetary policy mechanism. Such purchases, disposals or interest thereon are reflected as mere book entries in the records of CBSL. These are disclosed separately in Note 21 and Note 22 to these Financial Statements.

As the sole statutory authority, CBSL issues currency to the public in line with Monetary Law Act. Currency issued by CBSL represents a claim on the Bank in 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.

CBSL Securities

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

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

Investment Portfolio – Sri Lanka Government Securities

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

Advances to Government

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

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 counter parties 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.

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.

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

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

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 life and methods are reviewed, and adjusted if appropriate, regularly.

Intangible Assets

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

Receivables

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

Sundry Assets

Staff Loans

CBSL employees are entitled to loan facilities under concessionary interest rates. These loans are fair valued as per International Accounting Standard 39 using discounted cash flows.

Discount Rate - The rate compiled by the Economic Research Department of CBSL (ERD) based on the long term inflation target on USD - Commercial Interest Reference Rate (CIRR) plus 1 percent added for the risk premium as agreed by the Audit

Committee of the Bank is used as the discount rate and it varies with the period of the loans. (upto 15 yrs 10.93% and 15 to 30 years 9.78%)

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

Assumptions used for computation of fair valuation

- The staff loans granted during the year 2008 is considered.
- The date of staff loan granted is considered as 1st January 2008.
- There were no amendments or settlements for these loans.

Other sundry assets are carried at expected realisable values.

Impairment of Non-Financial Assets

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

Provisions

Provisions are recognised when the Bank has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the 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 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 and 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 majority is 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.

A Note on the Financial Statements of the Central Bank of Sri Lanka regarding their Compliance with IFRS

In addition to the statutory audit carried out by the Auditor General of the Democratic Socialist Republic of Sri Lanka in terms of the provisions of MLA, a separate special purpose audit was conducted by Ernst & Young, Chartered Accountants, to examine the compliance of the financial statements of the Central Bank with International Financial Reporting Standards (IFRS). Copies of this audit report have been submitted to the Monetary Board and the Auditor General.

The financial statements of the CBSL have been prepared in terms of IFRS since 2002 on a voluntary basis as desired by the Monetary Board, to make them comparable with those of other central banks in the world to bring the Central Bank's accounts up to date in terms of global practices and to facilitate the Central Bank to operate in the international capital and financial markets to engage in transactions on behalf of the government.

The report by Ernst and Young has been published separately.

2. BANK SUPERVISION

The Bank Supervision Department (BSD) was established under the Section 28(1) of the Monetary Law Act for the purposes of continuous supervision and periodical examination of all banking institutions in Sri Lanka. Accordingly, 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 BSD, with a view to mitigating risks in the banking sector in order to ensure the safety and soundness of the banking system and thereby preserve financial system stability. As at end 2008, 36 licensed banks, i.e., 22 licensed commercial banks (LCBs) and 14 licensed specialised banks (LSBs), were in operation under the regulation and supervision of the Central Bank. The names of these banks, in alphabetical order, are in Annex II-I.

With the sub prime crisis in the US becoming a global financial crisis, the year 2008 brought new challenges to the BSD to maintain the resilience of the banking system. The disturbances in the international financial market emphasised the importance of risk management, internal controls, accountability in bank management, corporate governance and compliance. In this regard, the BSD continued to promote sound risk management systems by moving on to Basel II, preparing for adoption of International Accounting Standards, drafting guidelines for implementation of an integrated risk management system in banks and amending existing Directions to strengthen the credit risk management of banks. Further, to ensure smooth implementation of the Directions on the Corporate Governance of banks, transitional provisions were introduced during the year under review and a symposium was held for the board of directors of banks to emphasise their responsibilities and fiduciary duties. The BSD also took swift action towards maintaining the stability of banks in distress thereby maintaining the stability of the financial system.

Accordingly, the activities undertaken in 2008 are given below.

2.1 Prudential regulations and related measures

A summary of the new prudential regulations and guidelines and the amendments to the existing prudential requirements issued by the BSD to the licensed banks in 2008 are as follows. Details of these regulations and guidelines are contained in Part III of this report.

(a) **Implementation of Basel II on the standardised approach:**

Commencing 2008, banks were required to apply the standardised approach for credit risk, the standardised measurement method for market risk and the basic indicator approach for operational risks. The reporting by banks based on this framework was examined and the returns were reviewed to ensure that all banks adhere to the correct norms of reporting as per the Direction.

(b) **Issue of amendments to the Direction on Corporate Governance:**

The Direction on Corporate Governance was challenged by a few banks in the Courts. The Supreme Court upheld the principles in the directions. The BSD issued an amendment incorporating transitional provisions based on the order of the Supreme Court on limits on the age, length of service and number of directorships that could be held by directors of licensed banks.

(c) **Classification of loans and advances, income recognition and provisioning:**

A consolidated Direction was issued by incorporating several new provisions to the existing ones with the objective of further strengthening the credit risk management of banks. Accordingly, banks are required to classify the credit facilities based on the period and on the potential risk where full recoverability is in doubt and these criteria will be applicable to both on-balance sheet and off-balance sheet items. Special classification criteria and provisioning requirements for credit cards were also introduced. Furthermore, a classification policy based on borrower rather than by credit facility will be implemented from January 2010.

(d) **Establishment of bank branches:**

A new policy guideline was issued requiring banks to establish at least two branches outside the Western Province for each new branch established in the Western Province. This will facilitate the enhancement of economic development in areas outside the Western Province and contribute to achieving balanced regional development in the country, enhancing access to finance, financial inclusion and promoting the savings habits, thereby increasing economic activities in those regions.

(e) **Adoption of Sri Lanka Accounting Standard (SLAS) 44 and SLAS 45:**

A Road Map was issued to the banking industry to fully comply with the SLASs corresponding to International Accounting Standards (IAS) 32 and 39 by year 2011. Further, several training programmes were conducted for bankers to enhance knowledge and to facilitate adoption of these new standards.

(f) **Guidelines on outsourcing of banking activities:**

Many banks have commenced outsourcing non-core functions to meet the challenges of technological innovation, increased specialisation, cost control and competition in the market. In order to standardise the regulatory requirements and to streamline the approval process for outsourcing activities, action was initiated to issue guidelines on outsourcing activities of banks. Industry comments are awaited.

(g) **Implementation of integrated risk management systems in banks:**

The draft guidelines, which provide the overall architecture for a bank's integrated risk management process, were released for the comments of the banking industry.

(h) **Margin requirement on Letters of Credit (LCs) and forward sales transactions in foreign exchange:**

With a view to restricting the possibilities of foreign exchange payments being routed outside the banking system for imports through documents against acceptance (DA) terms, guidelines were issued to the LCBs for the imposition of margin requirement of 100 percent on selected non-essential items. Further, in view of avoiding possible unhealthy speculative foreign exchange transactions and excessive volatility in foreign exchange market, licensed commercial banks were instructed to obtain a deposit of not less than 100 percent of the contract value at the time of entering into a forward sale contract of foreign exchange. These guidelines were effective from 31 October 2008.

2.2 Approvals for Banks, Branches and other Banking Outlets

The BSD continued to process the requests for new banking licences and for the opening, closing and relocation of bank branches and other banking outlets, in terms of the Banking Act. Commencing 2008, the

SME Bank Ltd was merged with the Lankaputhra Development Bank Ltd and approval was also granted for the Standard Chartered Bank Ltd to acquire the banking business of the Sri Lankan branch of the Standard Chartered Bank (Pakistan) Limited. Further, approval was granted to Bank of Ceylon for the subsidiarisation of its London branch while a Letter of Provisional Approval was granted for the establishment of Amana Bank Ltd. Due to increased interest shown by individuals/financial institutions both locally and abroad, to open new banks in Sri Lanka, guidelines on opening new banks, in line with the Banking Act, were made available in the public domain.

During the year, approvals were granted for 47 new branches, 486 other banking outlets (such as extension offices, mobile banking units and student savings units), relocation of 49 branches and 15 extension offices (EOs) and upgrading of 15 extension offices to fully fledged branches, installation of 24 off-site automated teller machines (ATMs) and closure of 2 ATMs and 1 EO. Accordingly, there were 1,787 branches, 2,622 other banking outlets and 1,569 ATMs in operation at the end of 2008. New banking products, which emerged with the innovative banking concepts such as remittances through mobile cash, doorstep banking and cash management services, were approved with a view to providing customer oriented services by banks.

2.3 Continuous Supervision of Licensed Banks

Continuous supervision is an early warning mechanism whereby any significant variations in the financial conditions, which require further investigation and examination, are identified through an ongoing monitoring process of the periodical information submitted by the banks through the web based reporting system. Status reports on banks were compiled periodically to assess the performance of the banks. In addition, reports were compiled on specific issues, including letters of credit opened by banks for vehicle importation, misuse of cheque return codes and the fees and commissions charged by licensed commercial banks and licensed specialised banks.

2.4 Statutory Examination of Licensed Banks

The Monetary Law Act and the Banking Act require the BSD to conduct periodical statutory examination of LCBs and LSBs. The examinations continued to adopt a risk based approach with a view to strengthening risk management policies, procedures and practices in respect of credit, market and operation risks in banks. In 2008, special attention

was paid to strengthen liquidity risk management, corporate governance practices and adoption of sound internal control mechanisms by licensed banks. The BSD handled 33 statutory examinations during 2008, which included 22 examinations that commenced in 2008 and the completion of 11 examinations that continued from 2007. Accordingly, the examinations of 16 banks were completed in 2008 through formal discussions with the management of the respective banks and submission of reports to the Monetary Board and 17 examinations are in the process of completion.

2.5 Resolution Action on the Seylan Bank PLC

The attention of the Monetary Board was drawn to events in the Golden Key Credit Card Company Ltd (a member of the Ceylinco Group), which resulted in difficulties being encountered by Seylan Bank PLC with regard to deposit withdrawals and ensuing liquidity problems. Thereupon, the Monetary Board, with a view to addressing any potential danger to financial system stability, under Section 30 of the MLA, decided to discontinue the services of all the directors of Seylan Bank PLC effective from 29 December 2008 and to appoint Bank of Ceylon to carry on the business of Seylan Bank PLC. Through such intervention, market confidence in Seylan Bank was restored and the threat to the stability of the financial system was satisfactorily dealt with.

2.6 Investigations of hedging transactions

Pursuant to media reports in early November 2008, the CBSL commenced investigations in connection with derivative transactions entered into by Ceylon Petroleum Corporation (CPC) with five banks, viz. Standard Chartered Bank, Citibank NA, Deutsche Bank AG, Commercial Bank of Ceylon and People's Bank. In the meantime there were also two fundamental right petitions filed in the Supreme Court in relation to these derivative transactions. The Supreme Court directed the Monetary Board to conduct an investigation with regard to the impugned transactions and take action thereon, which resulted in widening the scope of the examination conducted by the BSD. Accordingly, five spot examinations on oil hedging transactions carried out by the five banks were conducted and the reports were submitted to the Monetary Board and the Supreme Court. In addition, examination findings were reported to the Bribery Commission for further investigation, as directed by the Supreme Court. On 16 December 2008, the respective banks were informed not to proceed with or give affect to their transactions.

2.7 Investigations into the conduct of prohibited schemes

The investigations into the conduct of schemes prohibited under Section 83 (c) of the Banking Act were continued during 2008. In this regard the BSD attended to court proceedings relating to 9 cases heard in Anuradhapura, Balapitya, Maho-Kurunegala, Panwila, Teldeniya and Polpithigama. Advertisements were published in the newspapers in order to educate the public on the dangers of promoting and assisting illegal and fraudulent pyramid schemes.

2.8 Litigation

During the year 2008, there was litigation on several issues, such as the Direction on Corporate Governance, Direction on Share Ownership, Liquidation of Pramuka Bank, enhancement of equity capital requirement of banks, oil derivative transactions and other matters, in the District Court, High Court, Court of Appeal, Supreme Court, Labour Tribunal and Human Rights Commission. In this regard, there are 17 pending court cases whilst 16 cases were withdrawn by the plaintiffs, 03 cases were laid-by and 02 cases were settled during the year under review. During July 2008, the Supreme Court affirmed the Directions on the Corporate Governance for licensed banks and upheld the principles that there should be limits on the age, length of service and number of directorships that could be held by directors of licensed banks.

2.9 Amalgamation of Regional Development Banks (RDBs)

The Pradeshiya Sanwardena Bank (PSB) Act No 41 of 2008, which provides for the establishment of the PSB and absorption of the Regional Development Banks, was passed by Parliament in October 2008.

2.10 Increased interaction with Boards of Directors and Auditors

The first symposium for bank directors was held to enhance awareness of the responsibilities of the Boards of Directors and to discuss regulations, corporate governance and risk management, new initiatives on prudential and accounting standards, internal controls and audit functions. The Central Bank also meets the Board Audit Committees of banks and the external auditors of the banks, to ensure that banks adopt effective controls and to discuss supervisory concerns.

2.11 Inter Regulatory Institutions Council and other common fora

The Director of BSD continued to be a member of the Inter Regulatory Institutions Council (IRIC) which is responsible for ensuring that the 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. IRIC is chaired by the Governor of the Central Bank and comprises the heads of the National Payment Council, Sri Lanka Accounting and 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 and Department of Co-operative Development. The IRIC had three meetings in 2008. Further, the BSD continued to conduct monthly meetings with the Chief Executive Officers of licensed banks, which serve as a continuous forum to exchange views on issues and policies relating to the banking industry. The Working Group of Regulators on Financial Conglomerates continued its activities and had 08 meetings during the year. Additionally, the Director of Bank Supervision continued to serve as a member of the National Payment Council and as a Director of the Credit Information Bureau of Sri Lanka.

2.12 Annual Licence Fee

Various countries adopt different strategies towards recovering regulatory and supervisory costs. The Monetary Board, with a view to partially recovering the costs of bank supervision, carefully examined and decided to increase the annual licence fees of banks on a staggered basis, taking into consideration that licence fees have not been changed for over a decade. Accordingly, the licence fee for 2009 would be Rs. 500,000 for LCBs conducting both domestic banking business and off-shore banking business, Rs. 300,000 for LCBs conducting only off-shore banking business and Rs. 200,000 for LSBs.

2.13 Public awareness programmes

The BSD continued to disseminate information to the public with a view to educating the public on the financial system and the need to be aware of the risks and returns in their transactions with financial institutions. Accordingly, newspaper advertisements regarding registered financial institutions, institutions authorised to accept deposits, corporate governance and global financial crisis were published.

Annex II - I Licensed Commercial Banks

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

Licensed Specialised 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. Sri Lanka Savings Bank
12. State Mortgage and Investment Bank
13. Uva Development Bank
14. Wayamba Development Bank

3. CENTRE FOR BANKING STUDIES

The Centre for Banking Studies (CBS) took steps to enhance the coverage and quality of its training programmes for its stakeholders by offering wide spectrum of the training programmes, educational forums and public lectures at a higher standard in 2008. The CBS introduced a series of evening presentations and certificate courses on subjects of public interest. Furthermore, CBS took initiatives to create links with domestic and international institutions for knowledge sharing and creating synergy through strategic networking. The CBS has placed more emphasis on international training programmes with a view to re-positioning the CBS as an international centre of excellence. In this regard, the existing residential facilities of CBS have also been upgraded to international standards with a view to providing high quality services for both local and international participants.

During 2008, CBS was able to conduct 98 training programmes. This included 59 scheduled local programmes, 5 international programmes and 34 special programmes, offered on demand. Number of participants attended the above programmes were 1763, 171 and 1325 respectively. Training programmes covered a wide spectrum of Banking & Finance, Accounting & Financial Management, Legislation Relating to Financial Institutions, Information Technology, Languages & Communication Skills, Human Resource Management & General Management, Rural Sector Development and Micro-finance programmes. In addition, special programmes on important policy issues and financial sector developments were also conducted during the year.

The CBS also took steps to share knowledge with the general public through a series of public seminars, evening presentations and special educational programmes for school children and teachers. These seminars and lectures were designed to disseminate new ideas and to provide a forum for the general public to express their views and share their knowledge. During 2008, fifteen public seminars, four evening presentations and eighteen educational seminars were conducted with the participation of 3410, 236 and 2547 respectively. In addition to the educational seminars, thirteen television programmes were also conducted for the benefit of students and school teachers.

4. COMMUNICATIONS

Throughout the last year, amidst the global financial crisis, the Central Bank had to communicate intensely with the public through a wide range of media network. This type of concentrated communication effort was necessary since the public relied heavily on information relating to policy decisions taken by the CBSL on price, economic and financial system stability especially under a crisis situation. In this exercise, the Communications Department played a vital role in fulfilling the external and internal communication service requirements of the Bank.

As in the previous years, Department continued to release daily exchange rates, weekly and monthly economic indicators, Sri Lanka Inter Bank Offered Rates, oil prices, consumer price indices and information on Government Securities on Treasury Bills and Treasury Bonds auctions. During the year Department released 1,352 press releases, published 152 newspaper advertisements and 12 Gazette notifications. In addition to regular press releases and notices, Department organized 15 media conferences and arranged a number of one-on-one media interviews with the senior officials of the Central Bank to create constant public awareness on various economic and financial issues. To educate the journalists on current trends and issues in relation to global financial crisis and its impact on the country's economy, three luncheon meetings were arranged for journalists and heads of the media institutions.

With the support of key ministries and government institutions, the Department coordinated an International Reputation Management Campaign for the country. This campaign was implemented at a time when there was adverse international publicity on the country. The debut sovereign bond was trading in the international market during this period and this campaign helped this debut bond issue in a positive manner. The actual outcome of the campaign expected to reflect in the overall international outlook on Sri Lanka over a period of time.

The Bank's website played an important role as the main communication gateway through which a worldwide audience is linked to the Bank. With the introduction of new features such as Real Simple Syndication (RSS), on-line sales counter of commemorative coins and publications it became even more popular during the year. The number of users of the Website increased noticeably to 103,012 per day in 2008 compared to 88,000 per day in 2007 and 600 per day in 2006, respectively. With the

support of the relevant departments in the Bank, the Department kept an updated website in all three languages throughout the year.

Responding to frequent inquiries by the public for information on agency functions undertaken by the Bank on behalf of the government, action has been taken to link the relevant departments to Government Information Centre (GIC) so that public can access to CBSL information through 1919 hotline. Linking of Regional Development (RDD) and Exchange Control (ECD) has been successfully done during the year. Action has been taken to address the inquiries on Public Debt and Employment Provident Fund (EPF) also through this 1919 hotline.

With the objective of conveying the message of integrity, professionalism and objectivity through a carefully designed outlook a new corporate design for the CBSL was introduced. All the communications templates were redesigned accordingly and CBSL publications such as Annual Report, Strategic Plan, Road Map, Debt Bulletin etc. were given a new look.

In order to cater to internal communication requirements the Department continuously updated the CBSLdaily web-portal which provides day to day information ranging from weather report to local and foreign news relating to banking and finance, economic indicators announcements, presentations and notices to employees. It also facilitates an online forum for the employees to take part in constructive discussions on current topics. The number of hits on CBSLdaily website rose to 350 per day in 2008 from 300 hits per day in 2007. To enhance the awareness on departmental functions among the staff, Department continued to publish 'Kauluwa' the internal news and features magazine with added features and giving more space for the employees to express their views and ideas on various issues.

As in previous years the corporate management was provided with a collection of news, articles and views on country's economy and on Central Bank published in the national newspapers facilitating them to have an idea about how things are reported in the media. A total of 1,290 such news items on various economic financial and social issues were submitted to the management. Newspaper reports on Central Bank were analyzed to find out how the Bank is portrayed in the media and a presentation on the subject was made at the Heads of Department meeting. Erroneous reports published in the media were well addressed and corrected with the support of relevant departments.

Under education and public awareness, 24 public awareness programmes and school seminars on economics, banking and finance were conducted during the year. As per the request of RDD and PDD two documentary video films to promote cattle farming as a profitable household economic activity and investments on government securities respectively were produced. These programs were well received by the general public and in addition to telecasting to a mass audience, copies were made on DVDs and distributed among a specifically targeted audience. The Department participated in various exhibitions and other public events to enhance the public awareness on economic and financial information and on policies and responsibilities of the CBSL. The Bank's stall at the Colombo International Book Fair and Deyata Kirula exhibition recorded a significant public participation. Expo Lanka, Gamin Lovata and Poth Piyasa exhibitions were among other notable exhibitions. The Department could sell a large number of its publications at these stalls. During the year the Department opened a new Publication Sales Outlet at the Centre for Banking Studies (CBS), Rajagiriya for the convenience of the public.

A Tamil Translation Unit which had been long due, was established in the Department to fulfill all the Tamil translation requirements of the Bank. With this Department was able to handle the translations of press releases, advertisements, gazette notices and Bank's publications etc. more efficiently. This Unit handled 175 Tamil translations assignments during the year.

As in the previous years, Department continued to publish its own publications such as Satahana and News Survey in addition to serving as the publishing agent for other publications published by the Bank. The Central Bank Printing Press continued to serve for almost all the printing needs such as Sri Lanka Socio Economic Data, Economic and Social Statistics of Sri Lanka, News Survey, Satahana, Kauluwa, Staff Studies, Financial System Stability Review, Road Map, Strategic Plan, Public Debt Bulletin and other departmental requirements such as visiting cards, greetings cards, notepads, file covers, CBSL Diary etc.

Photographic coverage of all the major events conducted by the Bank was handled by the Photographic Unit of the Department. It covered sixty such events, within and outside of the Bank premises, during the year.

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 20,586 to 21,906, reports from 13,827 to 14,662, CDs from 1,082 to 1,142 and added 500 bound volumes to the collection during the year. The Library at the Centre for Banking Studies too increased its collection of books from 5,273 to 5,516.

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

In order to encourage bank staff to use on-line library facilities, 11 user education programmes covering 11 departments were conducted. For the benefit of the employees twenty four (24) documentary films produced on various important topics and subjects were shown during the lunch interval at the Lobby of the Library. Economics and Banking Library Network of Sri Lanka (EbanklibnetSL) was maintained 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 723 new titles purchased. A good response was shown by the staff for this exhibition. The Book Review Competition and Quiz Programme by e-mail were other popular items organised to mark the National Reading Month Programmes. A lecture on "Sri Lanka - Land and its preservation" was organised by the LIC to make the Bank Staff aware of this national issue.

Self Access Language Laboratory was shifted to the Reference Section of the Library and Information Centre to make easy access to this facility by CBSL Staff. Awarding ISO 9001: 2000 certification to the Library & Information Centre by the Sri Lanka Standards Institution is a unique achievement during the year under review.

5. CURRENCY

5.1 Currency Issue and Management:

The Central Bank of Sri Lanka as the sole currency issuing authority in Sri Lanka, continued to perform the function of issuing legal tender currency for the

use of domestic transactions during the year 2008. The volume of currency notes and coins in circulation by the end of 2008 stood at Rs. 186 billion. Notes in circulation comprised 97 per cent of the total value of currency in circulation. The value of new and serviceable currency notes issued to commercial banks by the Currency Department (CRD) during the year 2008 was Rs. 27 billion and Rs. 193 billion, respectively. The value of the deposits of currency notes from commercial banks was Rs. 207 billion. Accordingly, the net issue of currency notes and coins in to circulation by the end of 2008 stood at Rs. 13 billion and Rs. 252 million, respectively.

5.2 Cost effective measures for issuing and managing currency:

CRD continued the island wide coin collection programme to re-circulate idle coins accumulated in the household sector. Accordingly, nine districts were covered during 2008. The total face value of coins collected under this programme by the end of 2008 was around Rs. 50 million. The total net benefits in terms of savings were around Rs. 77 million, considering the cost of minting the stock of coins collected as against the cost incurred by CRD on the coin collection programme. CRD also exported coins with high metal value to replace them with low cost coins to secure the benefits of high metal values of coins issued in the past. The income generated through this project in 2008 was around Rs. 30 million. Further, the efficiency of processing currency was increased by acquiring high speed note counting machines.

5.3 Maintaining public confidence in currency:

To maintain public confidence in currency, which is one of the responsibilities of the Bank, CRD continued to work in close cooperation with the Counterfeit Currency Bureau of the Criminal Investigation Department (CID). Similarly, CRD attended 22 court cases on counterfeiting. The volume of counterfeit notes detected and referred to the Bank for certification during the year 2008 was around 2 notes per million notes in circulation. CRD also conducted public awareness programmes on new security features of genuine currency notes to enhance knowledge of law enforcement officers, cash handlers and the general public to enable them to distinguish between genuine notes and counterfeits.

5.4 Promoting Clean Note Policy:

Maintaining clean notes in circulation has multidimensional benefits to currency issue and management. Good habits of handling notes extend the life span of notes and help reduce cost of printing

new notes. Clean notes help distinguish between genuine notes and counterfeits and boost the image of the nation among foreigners. CRD continued with issuing new notes in to circulation and removing unserviceable notes as part of promoting the Clean Note Policy. Further, topics on good habits of handling currency notes and coins were discussed in the awareness programmes conducted during the year. Guidelines on sorting standards for notes were issued to commercial banks to maintain quality standards of notes in circulation. Samples of note bundles deposited by commercial banks were checked randomly to verify the quality of processing currency.

5.5 New Projects Implemented:

(a) New Currency Note Series

CRD launched an island wide competition inviting competent, creative and artistic citizens to contribute to design a new currency note series with the objective of attracting and promoting local talent and creativity. The project received a very good response with 1175 designs from 219 designers. The two most suitable designers were selected in the final round of selection. Designs for the new series have been finalized under the themes of “Development and Prosperity” and “Sri Lankan Dancers”.

(b) Money Museum at Anuradhapura

The second Money Museum of the Central Bank of Sri Lanka was opened at the Regional Office of the Central Bank in Anuradhapura, on 5th September 2008. The objective was to facilitate the general public including school children and both local and foreign visitors to the ancient city of Anuradhapura to collect information on currency in Sri Lanka and other selected countries. Ancient currencies used in Sri Lanka since the 3rd Century BC to date, coins and notes used in Sri Lanka under different colonial periods until the establishment of the Central Bank of Sri Lanka, notes and coins issued in various series by the Central Bank of Sri Lanka since 1951 and notes and coins of several foreign countries are some of the exhibits on display.

5.6 Promoting Awareness on Currency:

The CRD conducted awareness programs on the identification of counterfeit notes, clean note policy and re-circulation 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 programs conducted during 2008 was 15.

The CRD also participated in the following exhibitions with a view to enhancing public awareness on currency notes and coins and its historical developments in Sri Lanka.

1. “Abimani 2008” held at Attala Sri Bodhi Rukkharama Viharaya- Kegalle from 25th - 27th Jan. 2008.
2. “Deyata Kirula – 2008” held at BMICH from 04th - 10th Feb. 2008.
3. “Pulathisi Navodaya” held at Thopawewa College- Polonnaruwa from 03rd - 06th April 2008.
4. “Ruhunu Expo – Gamen Lowata” held at Suchi National School -Hambantota from 13th -14th Dec. 2008.

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

The Currency Museum at the Centre for Banking Studies at Rajagiriya was kept open on weekdays to cater to the needs of those interested in currency.

5.7 Sale of Commemorative Coins and Notes:

The Central Bank of Sri Lanka issued two sets of new commemorative coins in 2008. The first set was issued to mark the event of the Sri Lanka Cricket Team being the Runners-up in the 2007 Cricket World Cup tournament, in the denomination of Rs. 1000 (Nickel Plated Steel, Brilliant Uncirculated type) and Rs. 5 (Brass Plated Steel) to be circulated along with the existing Rs. 5 coin in circulation. The second set was to commemorate the 50th Anniversary of the Employees’ Provident Fund, in the denomination of Rs. 1000 (Nickel Plated Steel, Brilliant Uncirculated type) and Rs. 2 (Nickel Plated Steel) to be circulated along with the existing Rs. 2 coin.

The Department continued to sell commemorative coins, coin packs and the commemorative note to numismatists and collectors by implementing effective sales promotion strategies. Two credit card machines were installed at sales points of commemorative coins and Internet sales via CBSL website were launched on 8th August 2008.

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. The department also ensured the availability of funds for settlements to be made under the Real Time Gross Settlement System

(RTGS), by providing the Intra Day Liquidity Facility (ILF) to commercial banks and primary dealers.

6.1 Implementation of Monetary Policy

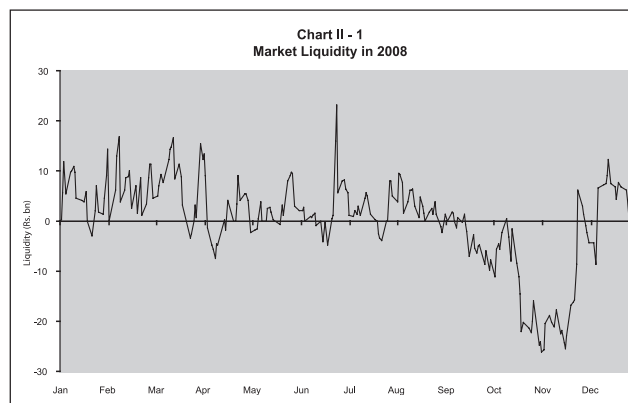
(a) Open Market Operations (OMO)

The department conducts OMO to maintain reserve money within the quarterly targets set to achieve the final objective of price stability and as far as it is feasible, to contain the volatility in the inter bank interest rates. Accordingly, the department absorbed liquidity aggressively while placing limits on access by commercial banks and primary dealers to funds from the Central Bank to achieve the reserve money targets and excessive volatility in interest rates was contained by establishing an upper ceiling on inter bank interest rates and preventing a buildup of excessive liquidity shortages in the banking system.

The absorption of liquidity was continued both on a temporary basis through overnight Repurchase (Repo) transactions and a permanent basis through outright sales of Treasury bills held by the Bank. In addition, this year, absorption on a relatively longer term basis was also introduced through term Repo transactions. Moreover, in the absence of a sufficient volume of Treasury bills with the Central Bank due to continued absorption, the Central Bank issued its own securities to absorb liquidity both on a daily basis and term basis.

In line with this strategy, the Central Bank continued with the limit on access of commercial banks and primary dealers to the Reverse Repurchase (Reverse Repo) facility of the Central Bank to three times per month per institute and the magnitude of the funds released under the facility to the estimated liquidity shortfall. The potential excessive volatility in inter bank rates was contained by providing funds under Reverse Repo facility over and above the allocation under the Reverse Repo rate of the Central Bank, at the penal rate of 19 per cent introduced in December 2007. A buildup of large liquidity shortages was prevented by providing liquidity through purchases of Treasury bills both in the primary and secondary markets and by reducing the Statutory Reserve Requirement.

On average, the liquidity position in the banking system remained at a surplus during the first three quarters and turned to a deficit during the last quarter of the year (Chart II – 1). Excess liquidity during the first quarter, of about Rs. 8 bn on average, was primarily attributed to the large inflow of foreign currency to the banking system, which was purchased by the Central Bank, whilst the peak in surplus liquidity in June was mainly due to the receipt of a



syndicated foreign loan to the government. As in the preceding years, the first two weeks in April depicted a liquidity shortage due to the high demand for currency during the festive season, followed by an increase in liquidity due to the return of these funds. Meanwhile, a substantial and prolonged liquidity deficit was experienced during the period of September to December as a consequence of the Central Bank continuing to supply foreign exchange to the market to meet the demand arising mainly from the withdrawal of a large part of foreign investments in government securities resulting from the global financial crisis.

The Central Bank's policy rates, i.e., the Repo and Reverse Repo rates, remained unchanged at 10.5 per cent and 12 per cent, respectively, throughout 2008. The penal rate was maintained at 19 per cent during this period.

(i) Auctions Under OMO

Overnight Repo Transactions

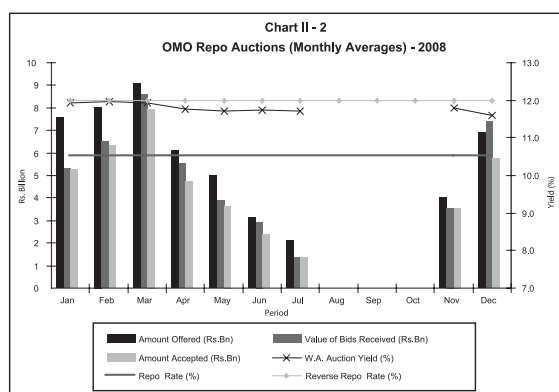
The liquidity surplus within the banking system was absorbed on a daily basis by conducting auctions to sell Treasury bills on a repurchase basis. On average, Rs. 6.6 bn was offered for the auction, whilst Rs. 5.2 bn, representing 71 per cent of estimated liquidity, was absorbed from the auction. The weighted average yield rate of the auctions depicted a decrease, reducing from 11.93 per cent in January to 11.6 per cent by December 2008 (Chart II - 2).

Term Repo Transactions

In May 2008, the Department introduced the term Repo auction to sell Treasury bills as a strategy to absorb liquidity on a relatively longer term basis. The period of the term auction was one week, whilst the weighted average yield rate was 15.94 per cent.

Reverse Repo Transactions

Reverse Repo auctions were not held during the year 2008.



(ii) Standing Facilities

The Department continued to provide the standing facility to Participating Institutions (PIs) at the Repo and Reverse Repo rates of the Central Bank. This facility was provided to PIs that were unable to manage their short term liquidity requirements fully through the inter bank money market and the daily OMO auctions.

Repo Transactions

The main investors in the Repo standing facility were those PIs who were unable to participate or those whose bids were rejected at the Repo auction. During 2008, Repo transactions under the standing facility were on average, about Rs 1.4 bn. per day, as the major portion of excess liquidity was absorbed through the OMO overnight Repo auction.

Reverse Repo Transactions

The purpose of the Central Bank's Reverse Repo facility (RRF) is to fulfill an urgent liquidity requirement of a participant, as a last resort, where access to alternative sources of funds is not available. As such, the Central Bank attempted to strike a balance between discouraging the excessive use of the RRF and meeting the liquidity requirements of PIs. Accordingly, the Central Bank decided to provide the RRF, at the Reverse Repo rate, upto three times per calendar month per participant and beyond this limit at a penal rate of 19 per cent per annum, with effect from 22nd February 2008, only on days when there was a liquidity shortfall in the system. In addition, RRF at the penal rate was also made available on days when the system's liquidity was broadly in balance.

During October 2008, when the market experienced a significant liquidity shortage due to the adverse developments in the global financial markets, the Central Bank relaxed the restrictions on RRF by

permitting PIs to utilise the RRF facility at the Reverse Repo rate upto 10 times per calendar month and to borrow at 19 per cent thereafter, in view of the urgent liquidity needs of the PIs. However, these restrictions were tightened once more to only three times a calendar month, with effect from 1st November 2008, in order to continue with the tight monetary policy stance.

The RRF under the standing facility was utilised extensively by PIs, especially during the last quarter of 2008, as a consequence of the substantial liquidity deficit in the system. Accordingly, RRF granted at the Reverse Repo rate and the penal rate amounted to Rs. 377.5 bn and Rs. 527 bn, respectively.

(iii) Issue of Central Bank Securities

Central Bank securities (CBSL securities) were issued on an overnight basis (with one day maturity) and term basis in the absence of a sufficient volume of Treasury bills with the Central Bank to absorb surplus liquidity. The first auction to issue CBSL securities on overnight basis was held on 26th June 2008 and these securities were subsequently used extensively during the period of July to September 2008, to absorb excess liquidity on overnight basis.

On average, Rs. 6.4 bn was offered for the CBSL securities auctions, whilst Rs. 5.2bn, representing 77.7 per cent of estimated liquidity during this period, was absorbed from the auctions. The weighted average yield rates of the auctions ranged between 11.64 per cent to 11.89 per cent during June to September 2008. CBSL securities were also issued under the standing facility at the Repo rate and the amount issued was on average, about Rs 1.4 bn. per day.

The Department also conducted several term auctions to issue CBSL securities, as a strategy to absorb liquidity on a relatively longer term basis. The total amount issued was Rs. 10 bn. The period of the term auctions ranged from two to three weeks, whilst the weighted average yield rates were around 15.7 per cent.

(iv) 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. Similarly, the Central Bank introduced auctions for the outright purchase of Treasury bills in order to inject liquidity to the market on a permanent basis in October 2008, for the first time after introducing the OMO framework of market based monetary policy operations in 2003.

The total value of Treasury bills sold and purchased through these outright auctions amounted to Rs. 26.6 bn and Rs. 8 bn, respectively. The tenure of the Treasury bills sold were very short term, ranging from 10 to 49 days, whilst the yield rates were below the comparable weighted average yield rates of 91 day Treasury bills in the primary market. In contrast, the tenure of the Treasury bills purchased tended to be relatively longer, with the remaining days to maturity ranging from 53 to 291 days. The weighted average rate of these purchases were above the comparable weighted average yield rates of Treasury bills in the primary market at the time of each outright purchase.

(b) *Statutory Reserve Requirement (SRR)*

The Department is responsible for enforcing the SRR as a monetary policy instrument. The prolonged liquidity shortage in the banking system, resulting from the Central Bank's intervention in the market to supply foreign currency to meet the demand in the domestic dollar market, led to adverse consequences on economic activities. The Central Bank initiated measures to inject additional liquidity on a permanent basis to ease any liquidity constraints that may arise, by reducing the SRR. Accordingly, the SRR, which had remained unchanged at 10 per cent since 19th October 2001 was reduced by 75 basis points to 9.25 per cent of deposit liabilities, with effect from 17th October 2008, thus releasing liquidity of about Rs. 7.5 bn into the market. However, in view of the continued liquidity deficit, the SRR was further reduced by 150 basis points to 7.75 per cent, with effect from 28th November 2008. This move released a further Rs. 17 bn into the market, thus easing the liquidity shortfall.

(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

6.2.1 Accounts of Financial Institutions

The Department provided current account facilities to commercial banks and primary dealers, to ensure an efficient inter bank payment and settlement system, thus facilitating the Central Bank's role of being the Banker to commercial banks. These accounts were operated on a Real Time Gross Settlement (RTGS) basis within the automated general ledger system of the Bank.

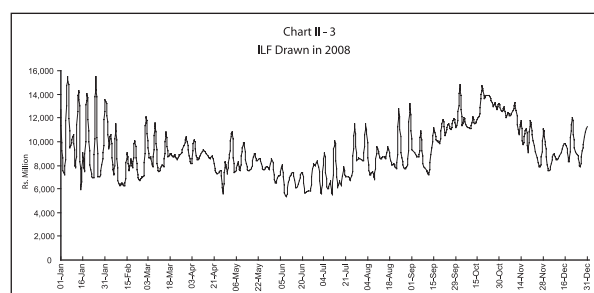
6.2.2 Government Accounts

The Department also maintained the accounts of government departments, government agencies and institutions and certain statutory boards, providing them with required banking facilities, in functioning as the Banker to the government. The total number of accounts maintained by the Central Bank amounted to 52 as at end 2008, with two new accounts being opened and two being closed at the request of the government. In terms of Section 89 of the Monetary Law Act, the Central Bank provides provisional advances to the government free of charge, with the limit on such advances being 10 per cent of the estimated government revenue. In 2008, the limit on the provisional advance was increased by Rs. 15.1 bn. to Rs. 77 bn.

6.3 Provision of Intra Day Liquidity Facility (ILF)

The Department ensured the smooth and efficient functioning of the RTGS system by providing ILF to commercial banks and primary dealers. This facility was provided free of charge against the collateral of government Treasury bills and bonds, which 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 and average value of ILF drawn during the year amounted to Rs. 2,186 bn and Rs. 9.07 bn, respectively (Chart II – 3), whilst the corresponding figures for 2007 were Rs. 1,222 bn and Rs. 5.03 bn respectively. Implementing strict measures, such as the 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. As a consequence, there were no ILF defaults during the year.



7. ECONOMIC RESEARCH

The Economic Research Department (ERD) continued to discharge its statutory responsibilities, while functioning as the 'Economic Think Tank' in the Central Bank. In fulfilling its vital statutory obligations, ERD engaged itself in providing

information, economic analyses and advice to the Monetary Board, to assist the Board in formulating and implementing monetary policy and to perform the Bank's function as the economic advisor to the government. The dissemination of economic information to the general public is also an important responsibility vested with ERD. In carrying out these responsibilities, ERD continued its policy oriented economic research, while collecting information related to economic activities from both domestic and international sources and analysing such data as essential inputs for guiding the Monetary Board in the formulation and conduct of monetary policy and improving the understanding of various issues to generate better policy outcomes. In addition, the Department actively provided its expertise to a number of initiatives commenced by the government during the year, while providing policy advice on economic issues to other departments in the Bank, the government and various other stakeholders. ERD continued to disseminate economic and financial information for the benefit of the general public regularly through statutory and other publications, press releases, and economic indicators and updates in the Central Bank website.

The evidence based research activities conducted by ERD were primarily focused on the formulation and implementation of monetary policy. They also aimed at appropriate design and implementation of policies in the other economic sectors in line with broader macroeconomic objectives of the country. These deliberations were particularly directed towards performing ERD's vital role in facilitating and strengthening the efforts of Monetary Policy Committee (MPC), which is engaged in analysing and making recommendations on monetary policy, for the consideration of the Monetary Board. The comprehensive reports of economic analysis, prepared by ERD, after incorporating views and concerns of MPC, were submitted to the Monetary Board for the purpose of monetary policy decision making. Furthermore, in order to keep the Monetary Board abreast with the latest developments in the economy, regular updates on the state of the economy were submitted to the Monetary Board by ERD.

The economic research activities were also continued on subjects of contemporary importance. Among those, the following research papers, completed in 2008 were published in the Bank's Staff Studies Volume 38, Nos. 1 & 2 of 2008.

- (a) "The Impact of Monetary Policy on Economic Growth and Inflation in Sri Lanka" by Mr. C. Amarasekara
- (b) "Inflation Targeting versus Monetary Targeting – The Case of Sri Lanka" by Miss S.M.Wimalasuriya
- (c) "Is the Export-Led Growth Hypothesis Valid for Sri Lanka? A Time Series Analysis of Export-Led Growth Hypothesis" by Mrs. W. A. Dilrukshini
- (d) "Stock Market Efficiency and Integration: A Study of Eight Economies in the Asia-Pacific Region" by Mrs. Dimuthu Samarasinghe

ERD also co-ordinated the inaugural international research conference on "Central Banking and Financial Markets", with a view to sharing research outcomes among the regional Central Banks. The staff of ERD was also engaged in conducting joint research with international organisations such as SEACEN Centre. Moreover, a research discussion series was commenced to discuss selected published research papers with a view to encouraging officers in the Bank to conduct economic research. In addition, a weekly discussion series was also commenced within the Department to share views on topical issues with the participation of all the staff members of ERD.

The public policy statement of the Central Bank, the "Road Map for Monetary and Financial Sector Policies for 2008 and beyond" (Road Map-2008), which was announced to the stakeholders on 02 January 2008, was prepared by ERD. It contained an analysis on the developments in the economy and the conduct of monetary and financial sector policies in 2007, monetary policy and financial stability targets for 2008 and challenges in achieving them. The main objective of this publication was to enhance the policy predictability and transparency, which will help stakeholders to formulate and better calibrate their own plans and strategies for the period ahead. A similar policy statement was prepared for 2009 as well, which was announced on 02 January 2009.

ERD also coordinated the work related to Monetary Policy Consultative Committee (MPCC), which has been established to further strengthen the monetary policy decision making process, through acquiring the expertise of outside experts. The MPCC comprised 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. During the year, the MPCC met on a monthly basis to review economic developments and made valuable contributions to enhance the monetary policy decision making process. Dr. G. Uswattearachchi was also

appointed as a member of MPCC with effect from January 2009 in order to broaden the expertise of the Committee.

ERD submitted a number of policy papers to the Monetary Board in providing pro-active policy advice to the government. The Department continued to provide independent views on Cabinet Papers, which have important economic implications. The evaluation of monetary implications of all foreign loans obtained by the government was also continued by the Department.

During the year, a special survey was conducted by ERD on the factory industry performance in the first half of 2008 and the outlook with the participation of major companies of all the industrial categories. The ERD also completed the data collection related to the Survey on Local Governments, which has been designed to obtain local level fiscal data. ERD interacted with a number of public institutions to discuss various policy initiatives. This included policy level discussions with Ministry of Healthcare and Nutrition, Ministry of Environment and Natural Resources and discussions with some higher education institutions. ERD also organised meetings with various private sector representatives to enhance the quality of the information collected by the Department from the private sector industries.

Senior officials of ERD rendered their expertise by serving in several Cabinet Appointed Committees on economic matters and various other external Committees. This included the National Economic Council, Electricity Tariff Committee, Power Generation Expansion Committee, Food Security and Cost of Living Committee and Sapugaskanda Oil Refinery Expansion and Modernisation Project Evaluation Committee. In addition, ERD was also engaged in the work related to the Stabilisation Fund for Tea, which was re-activated by the government in October 2008. The Director of ERD was appointed as the Chairman of this Fund. ERD officials also participated in the non-Deal Road Shows conducted by the Central Bank in Bahrain, Dubai and Abu Dhabi.

The primary responsibility of preparing the statutory reports and other special reports of the Bank in all three languages lies with ERD. Accordingly, ERD coordinated the publication of the Bank's Annual Report for 2007, Recent Economic Developments – Highlights of 2008 and Prospects for 2009, and Monthly Bulletins. The preparation of the September 15th Report, a confidential report submitted by the Bank under the provisions of the Monetary Law Act (MLA) to the Minister of Finance to facilitate the

preparation of the government budget, was also completed. As a vital part of its responsibility for disseminating information on economic matters to the general public, ERD continued to issue regular press releases on monetary policy, balance of payments and international trade. Press releases were also issued from time to time to explain and clarify various economic developments, issues, claims and mis-conceptions.

ERD also got engaged in coordinating the relations with other international multilateral financial organisations on behalf of the Central Bank and the government on a continuous basis. This included the co-ordination of the work related to the annual IMF Article IV Consultation missions, the SAARCFINANCE Governors' Symposium, the Inter-governmental Group of Twenty Four (G-24), the SEACEN Research and Training Centre, and the SEANZA group. The ERD continued to provide necessary data to international organisations such as SEACEN, IMF, etc. on a regular basis. The Department continued to work closely with the international sovereign rating agencies i.e. Fitch Ratings and S&P Ratings Services. In the process of coordination with the World Bank, the Asian Development Bank and other various multilateral and bilateral development partners, ERD extended its assistance to Ministry of Finance and Planning.

8. EMPLOYEES' PROVIDENT FUND (E.P.F.)

The operations of the Employees' Provident Fund Department (EPF 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, crediting interest to member accounts 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 performed the above activities during 2008 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 2008 stood at Rs. 645.0 billion reflecting an increase of 17.4 per cent or Rs. 95.6 billion from Rs. 549.4 billion as at end 2007 (Table II-1). This was mainly due to the increase in number of members and their contributions during the year and distribution of income among the members for the year. The total number of member-accounts increased to 12.46 million of which 2.3 million were contributing/active member accounts. The number of contributing employers stood at 64,000 at the end of 2008 registering an increase of 4.7 per cent from 61,116 in 2007. The net contribution (contribution less refunds of benefits) stood at Rs. 20.02 billion during the year compared with Rs. 18.8 billion in 2007. The total amount refunded to members and their legal heirs in 2008 was Rs. 25.9 billion, showing an increase of 19.2 per cent from Rs. 21.8 billion in 2007 while the number of refunds increased by 2.8 per cent over the previous year.

Table II-1
The Basic Information of the Fund

Item	2007	2008	Change (%)
Total number or member accounts '000	11,888	12,463*	4.84
Contributing member accounts '000	2,181	2,296*	5.27
Non-contributing member accounts '000	9,707	10,167*	4.74
Contributing employers	61,116	64,000*	4.72
Total contributions (Rs.mn)	40,574	45,951	13.20
Total refunds (Rs. mn)	21,752	25,931	19.20
Number of refunds	97,936	100,706	2.83
Total liability to members (Rs.bn)	549.4	645	17.40
Total value of the Fund (Rs.bn)	560.4	653.2	16.56

*Provisional

Source: Employees' Provident Fund

8.2 Investment of Funds and Return

(a) Investment Portfolio: The total investment portfolio of the Fund grew by 15.8 per cent to Rs.627 billion as at end 2008 from Rs. 541 billion as at end 2007 (Table II-2). EPF Department continued to invest the moneys of the Fund in line with the Fund's investment policy, i.e. to ensure a long-term positive real rate of return to the members while maintaining the safety of funds and liquidity to meet refund payments and other expenditure. Accordingly, 96.9 per cent of the portfolio was held in government securities. The balance was placed on corporate debentures, equities (2.5 per cent) and high liquid

Table II-2
Investment Portfolio

Type of Investment	2007		2008	
	Rs. bn	Share (%)	Rs. bn	Share(%)
Treasury bonds & bills	453.7	83.8	539.6	86.0
Rupee Loans to Government	68.9	12.7	68.5	10.9
Corporate Debentures	7.9	1.5	8.7	1.4
Equity	6.7	1.2	6.9	1.1
Repos and Other	4.3	0.8	3.5	0.6
Total	541.5	100.0	627.2	100.0

Source: Employees' Provident Fund

assets such as repos (0.6 per cent) to maintain a healthy liquidity position.

(b) Revenue: Total income on investments increased by 33.8 per cent to Rs. 79.5 billion in 2008 from Rs. 59.4 billion in 2007 (Table II-3). As in the past, the interest income including amortization gain was the major source of income to the Fund. This has been attributed to discounted bonds in the government securities portfolio. Interest income grew by Rs. 20.1 billion to Rs. 78.9 billion from Rs. 58.8 billion in 2007. The rate of return on average total portfolio increased to 13.8 per cent in 2008 from 12.7 per cent in 2007. Since 96.5 per cent of the funds were invested in government securities at different interest rates in the past, the total return on investment was highly correlated with maturity profile of government securities portfolio. The Weighted Average Return on government securities for the year 2008 was 13.9 per cent and yield varied between 10.4 per cent and 15.3 percent depending on the maturity as at the end of 2008 (Table II-4). The capital gains and dividends realized from equity portfolio declined significantly by 48 per cent to Rs. 225 million in 2008 from Rs. 434 million in 2007 mainly due to depressed market conditions. Accordingly, the rate of return on the average equity portfolio stood at 3.8 per cent as against 8.3 per cent in 2007.

Table II-3
Income on Investment

Source of Income	2007		2008	
	Rs. mn	Share (%)	Rs. mn	Share(%)
Interest	49,885	84.0	61,445	77.3
Dividends	146	0.2	152	0.2
Capital Gain	288	0.5	108	0.1
Amortized Gain	8,945	15.0	17,452	22.0
Other	158	0.3	306	0.4
Total Income	59,422	100.0	79,463	100.0

Source: Employees' Provident Fund

Table II- 4

Maturity Profile of Government Securities Portfolio - End of 2008

Maturity	Amount Rs. mn	Share (%)	Weighted Average Yield (%)
Less than 1 year	124,363	20	10.41
1-2 years	206,684	34	15.33
3-4 years	218,881	36	14.83
More than 5 years	61,780	10	13.34
Total	611,708	100	13.95

Source: Employees' Provident Fund

(c) Expenses: Total operational expenditure of the Fund rose by 16.5 per cent to Rs. 637 million in 2008 from Rs. 546 million in 2007 (Table II-5). The Fund managed to maintain its total operational expenditure at 0.80 per cent of its total gross income in 2008. Maintaining operational expenditure below 1 per cent of the gross income has been a key feature of the Fund over the years.

Table II- 5
Operating Expenditure

Expenditure Items	2007	2008	Change (%)
Personnel expenses	318.2	323.1	1.5
Administration expenses	211.0	289.0	37.0
Financial expenses	16.9	24.7	46.7
Total expenses	546.1	636.8	16.5
Total expenses as a % of Gross Revenue	0.90	0.80	(0.1)

Source: Employees' Provident Fund

8.3 Payment of Interest on Member Balances

In 2008, a sum of Rs. 75,466 million was available for distribution as interest to the members of the Fund (Table II-6). Accordingly, interest payments to member balances stood at a rate of 13.2 per cent on total member balances. When compared to the interest rate of 11.2 per cent paid to members in 2007, this was an increase of 200 basis points. However, in view of the practice of paying interest on the year-end balance for the full year, the Effective Rate of Interest (EIR)¹ is estimated at 13.44 per cent.

8.4 Member-Account Statements

The member-account statements for the first half of 2008 were issued to members through their employers during December 2008. Arrangements were made to issue account statements for the second half of 2008 by end of June 2009.

¹ EIR=(Interest Paid to Members) /[(Beginning of the year member balances +Year end member balances)]/2

Table II- 6
Payments of Interest to Members

Item	2007 Rs. Mn	2008 Rs. Mn	Change %
Gross revenue	59,422	79,463	33.70
Total operating expenses	546	637	16.60
Income tax	4,451	5,426	21.90
Net Income available for distribution	54,612	73,618	34.80
Interest paid on current refunds	879	1,152	31.20
Net income available for distribution (after payment of interest on current refunds)	53,733	72,466	34.86
Transfers from Reserves	1,725	3,000	73.91
Net income available for distribution after transferring from reserves	55,458	75,466	36.07
Interest paid on member balances	55,240	75,027	35.82
Carried forward balance	218	439	101.40
Interest rate paid on member balances %	11.2	13.2	2.00

Source: Employees' Provident Fund

8.5 Housing Loan Facility

EPF continued to issue certificates of guarantees to members as against their EPF balances under the Housing Loan Scheme. This scheme which was introduced in 1988 facilitates the members to obtain housing loans from 6 participating lending institutions, namely, Bank of Ceylon, People's Bank, Housing Development and Finance Corporation, State Mortgage and Investment Bank, Co-operative Rural Banks and National Housing and Development Authority. During the year, 13,133 member-balance certificates were issued to participating lending institutions for approval of housing loans amounting to Rs. 3,181 million (Table II- 7). Meanwhile, nearly Rs.1,400 million was deducted from relevant member accounts for remitting to the participating lending institutions to settle the loans in arrears for the year 2008. During the period 2000 - 2008, nearly Rs. 23.5 billion of credit was approved for 137,340 members and Rs.7,207 million were remitted to participating lending institutions to settle loans in arrears.

8.6 Public Awareness

EPF continued its public awareness programmes in 2008. During the year, 2 mobile services (Nildandahinna Estate at Walapane and Kelaniweli Plantation at Nuwaraeliya) and 10 seminars for employers regarding collection of member information through electronic media and Re-registration of members (7 seminars for all BOI

Table II- 7
Housing Loan Facility

Year	No. of Certificates Issued	Credit Approved	Rs.Mn Amount Remitted to Lending Institutions
2000	12,938	1,648	262
2001	16,066	2,091	381
2002	19,502	2,673	541
2003	18,689	2,792	670
2004	14,307	2,452	735
2005	14,600	2,766	900
2006	15,136	3,049	1,078
2007	12,969	2,872	1,240
2008	13,133	3,181	1,400
Total	137,340	23,524	7,207

Source: Employees' Provident Fund

zones, 3 seminars for employers of Colombo, Kaluthara and Gampaha Districts) were conducted. The Department also participated in 2 public exhibitions (HR Service Providers' Exhibition and Deyata Kirula). Meanwhile, several press advertisements were issued to inform the members of half-yearly Member Account Statements and the Re-registration Project.

8.7 50th Anniversary of EPF

EPF completed 50 years of service on 1st of June 2008. To mark its Golden Jubilee, EPF Department and Labour Department jointly organized an awareness programme on 11th September 2008 at BMICH. In addition, three types of commemorative coins, i.e., Nickel Plated Steel Frosted Proof Uncirculated Coin with a face value of Rs. 1,000, Nickel Plated Steel Brilliant Uncirculated Coin with a face value of Rs. 1,000 and Nickel Plated Steel Circulation Coin with a face value of Rs. 2 were issued. Further, TV and radio programmes and a press conference were conducted in collaboration with the Labour Department.

8.8 System Development

The 2nd Phase of the EPF web site was launched by introducing a web-based member information service to enhance the quality of member services with the technical support of IT Department. The new facility provides members to access information such as account balance inquiry, current contribution details, status of the refund application and housing loan application through internet. In addition, SMS information service was also introduced. During the 4th quarter, 340 members were registered under SMS information service.

8.9 Re-registration of Members

The Re-registration Project was launched as the 1st Phase of the Re-engineering of the EPF towards a fully IT-based system. The Department of Labour

and the EPF Department commenced a joint project to re-register all members of the Fund by names as appearing in the National Identity Card (NIC), assign the NIC numbers as their member numbers, amalgamate their previous member accounts and obtain their thumb impressions in digital form with a view to developing an on-line and more secured member account system. At the end of 2008, 70 per cent of member information has been collected. The data verification and updating of the database will be completed by the end of 2009. The Re-engineering Project would enable the EPF to manage the Fund in an operational model of a bank with appropriate systems for management information and risk management.

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 during the year 2008 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. The exchange control function was realigned towards the policy direction announced in the Central Bank Road Map 2008. The policy direction was to use the exchange control function innovatively to channel foreign resources to fill the domestic resources gap and to facilitate the process of accessing global financial centers to generate comparative advantages for Sri Lanka.

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 2008 with a view to further rationalize foreign exchange transactions with further liberalization and to promote international investor confidence. 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 investment in Treasury bills by foreign Investors:** The citizens of foreign states, corporate bodies incorporated outside Sri Lanka and foreign institutional investors such as foreign country funds, mutual funds and regional funds may purchase, sell or transfer

- Treasury bills, provided that all such investments in aggregate do not exceed 10 % of the total outstanding Treasury bill stock through a special rupee account named “Treasury bill Investment External Rupee Account (TIERA-2)”.
- (b) **Foreign Currency Accounts for Gem & Jewellery Exporters:** Authorized dealers were permitted to open and maintain foreign currency accounts (“Foreign Currency Account for Gem & Jewellery Exporters”) to facilitate foreign exchange requirements of exporters of Gem & Jewellery Industry in Sri Lanka as a policy measure to encourage them.
- (c) **Special Foreign Investment Deposit Account (SFIDA):** Citizens of foreign states, Sri Lankan citizens resident outside Sri Lanka, corporate bodies incorporated outside Sri Lanka and foreign institutional investors such as country funds, mutual funds and regional funds were permitted to open and maintain Time and Savings deposits in designated foreign currency or in Sri Lanka Rupees. The minimum amount of a deposit should not be below US\$ 10,000 or its equivalent in other designated foreign currency or Sri Lankan Rupees at Domestic Banking Units of licensed commercial banks and the total deposit liabilities on SFIDAs of an authorized dealer should not exceed 20 per cent of total deposit liabilities of its Domestic Banking Unit. Further, SFIDA accounts are exempted from the income tax, withholding of income tax and debit tax.
- (d) **Outward Remittance of Funds from Non-Resident Blocked Accounts:** Authorized dealers were granted permission for outward remittance of total balance standing to the credit of existing non-resident blocked accounts as at 01st July 2008 to the account holders or their legitimate beneficiaries. Permission was also granted for the outward remittance of funds equivalent to a maximum of US\$ 20,000 per annum from blocked accounts operative after 01st July 2008.
- (e) **Sale of Foreign Exchange to Emigrants:** Authorized dealers were granted permission to sell foreign exchange in designated foreign currency for outward remittance to emigrants up to a maximum amount equivalent to US\$ 150,000 including value of personal effects and personal jewellery per family or per individual not accompanying a family at the time of their departure from Sri Lanka. Funds belonging to emigrants in excess of US\$ 150,000 should be credited to a blocked account.
- (f) **Special Accounts for Senior Foreign Nationals:** Under the “Sri Lanka- MY DREAM HOME PROGRAMME” introduced by the Government to welcome senior foreign nationals who wish to prolong their stay in Sri Lanka on Resident Visa, “Senior Foreign Nationals’ Fixed Deposit Account (SFNFDA)” were introduced to facilitate their transactions and a minimum inward remittance of US\$ 15,000 or its equivalent in other designated foreign currency was required to be deposited in this account. In addition, a monthly remittance of US\$ 1,500 or its equivalent in other designated foreign currency for the principal applicant and US\$ 750 or its equivalent in other designated foreign currency for accompanying spouse and each dependent child are required to be deposited in a Sri Lanka Rupee Account for their up keep in Sri Lanka.
- (g) **Issuance of Foreign Currency Notes to Sri Lankans Travelling Abroad:** The issuance of foreign currency notes as a part of the travel allowance for Sri Lankans travelling abroad was increased to US\$ 2,000 or its equivalent in other designated foreign currency from the level of US\$ 1,000.
- (h) **Permitting Licensed Commercial Banks to trade in the International Sovereign Bonds (ISB) issued in 2007 by the Government of Sri Lanka:** Authorized dealers were permitted in terms of provisions of section 7 (a) of the Exchange Control Act to make payments to persons resident outside Sri Lanka in respect of purchase of ISB and in terms of provisions of sections 11 (2) and 17(2) to transfer ISB to persons resident outside Sri Lanka and to trade such ISB among authorized dealers.
- (i) **Monitoring Scheme on Release of Foreign Exchange for Travel Purposes:** Authorized dealers were requested that any release of foreign exchange by them for the purpose of travel abroad exceeding US\$ 5,000 or its equivalent in other designated foreign currency per person be reported to the Controller of Exchange with effect from 3rd November 2008 on a monthly basis.
- (j) **Opening of Resident Foreign Currency (RFC) Accounts:** The minimum required deposit for opening an RFC account was reduced from US\$ 500 or its equivalent in other designated foreign currency to US\$ 100 or its equivalent in other designated foreign currency.

- (k) **Acceptance of foreign currency to RFC/ NRFC Accounts:** Authorized dealers were permitted to accept any amount of designated foreign currency brought by the account holder to the credit of RFC or NRFC accounts without Customs confirmation on passport or Customs Declaration Card. Permission was also granted to accept any amount of designated foreign currency to the credit of NRFC accounts from immediate family members of the account holder.
- (l) **Margin Requirements for Imports made on Advance Payment Terms:** A margin deposit of 100 per cent on the total invoiced value of the goods imported against advance payments terms was imposed for importers at the time of effecting of the advance. Goods imported for re-export purposes under the Entrepot Trade were exempted from this margin requirement.

9.2 Approval for Investment abroad and Foreign Borrowing:

The ECD processed 85 requests for approval of investments abroad and borrowings from abroad and granted approvals for 41 requests highlighted below in terms of the relevant provisions of the Exchange Control Act.

- (a) Approvals for 20 resident companies to invest abroad amounting to US\$ 7.16 million, mainly in the areas of investment banking, trading, shipping, retail operations and employee share option schemes;
- (b) Approvals for 21 resident companies to borrow from abroad to a total sum of approximately US\$ 124.36 million.

9.3 Issuance of permits /licenses 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) Twenty nine new companies were registered as Freight Forwarders bringing the total number of Freight Forwarders to 277 at the end of 2008;
- (b) Five new money changer licenses were issued and three licenses were withdrawn bringing the total number of money changers to 68. Further, ten money changers who were successful in purchasing foreign currency over US\$ 4 million per annum were permitted to sell foreign currency;

- (c) Fifty new permits were issued to other restricted dealers such as duty free shops, tourist hotels, tourist restaurants, travel agents and gem and jewellery shops bringing the total number of such restricted dealers to 701.

9.4 Surveillance on Foreign Exchange Transactions

The ECD continued to strengthen its surveillance on foreign exchange transactions reported by relevant parties such as authorized dealers, restricted dealers and money changers with a view to promoting market discipline.

The information reported included sales and purchases of foreign exchange transactions through Electronic Fund Transfer Cards and several types of permitted foreign currency accounts schemes. During the year, installation of a web-based reporting system was completed. It enable the ECD to develop an on-line monitoring system to assess the extent of foreign exchange flows.

9.5 Investigations into violations of the provisions of the Exchange Control Act

One Hundred and Thirty Five (135) investigations into alleged contraventions of the provisions of the Exchange Control Act by various parties were concluded during the year 2008 and penalties imposed on such parties amounted to **Rs. 16,890,331.19** credited to Consolidated Fund.

These investigations mainly related to the unauthorized acceptances of foreign currency, unauthorized fund transfers by individuals and co-operate bodies, making investments in securities in contravention of the stipulated procedures and unauthorized purchases of foreign currency.

9.6 Other Activities- Awareness on Worker Remittances

In continuation efforts to promote of worker remittances through the banking and other formal channels in various ways, one day awareness programme was conducted for 300 prospective migrant workers in Kurunegala in association with Sri Lanka Bureau of Foreign Employment and banks. At this programme most of the prospective migrant workers were resolved their ambiguities relating to foreign currency remittances.

10. FINANCIAL INTELLIGENCE UNIT

The Financial Intelligence Unit (FIU) continued its operations during the year 2008 in terms of the relevant provisions of the Financial Transactions Reporting Act (FTRA) No 6 of 2006. Its main

operations include collection of information on financial transactions that may relate to money laundering, financing of terrorism and unlawful activities defined in the FTRA, conducting investigations into suspicious financial transactions, dissemination of information and details of investigations to relevant regulatory and law enforcement authorities to institute legal/enforcement action and issue of regulations on customer due diligence and suspicious transactions to prevent offences covered in relevant statutes. The highlights of main operations during 2008 are as follows.

10.1 Collection of Information and Investigations

In terms of the requirements imposed by the FIU, Licensed Commercial Banks (LCBs), Licensed Specialised Banks (LSBs), Registered Finance Companies (RFCs), and Stock Brokering Firms (SBs) continued to report cash transactions and electronic fund transfers subject to the specified reporting threshold of Rs. 500,000 or its equivalent in foreign currencies until 31 May 2008 and Rs. 1,000,000 or its equivalent in foreign currencies effective from June 01, 2008. During the year under consideration, the coverage of the reporting institutions was expanded to include insurance industry as well. The IT System viz, LankaFIN, designed to analyse information/data reported by reporting institutions to detect suspicious transactions was completed during the year. This system enabled the FIU to scrutinize over 2.5 million transactions during the year and to examine 247 suspicious transactions. In addition, the reporting institutions submitted reports on 90 suspicious transactions. After conducting preliminary investigations, 12 suspicious transactions were referred to the law enforcement agencies. Attorney General's Department and the Criminal Investigation Department (CID) filed indictments in relation to two such suspicious transactions.

10.2 Issue of Directions/Regulations and Implementation

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 (KYC/CDD)" to Insurance Industry. These rules require insurance companies to have detailed information on customers including the nature and sources of their financial transactions. Further, insurance companies were required to establish an anti-money laundering programme including staff training, written policies, procedures and internal controls.

- (ii) In order to strengthen the good governance on AML/CFT, four directives were issued to reporting institutions requiring them to institute strict KYC/CDD measures and to resolve certain compliance lapses on reporting requirements.

10.3 Other Activities

- (i) **Signing of Memorandums of Understanding (MOUs) :** Three MOUs were signed in 2008 with the Central Bank of Malaysia (Bank Negara Malaysia), Central Bank of Afghanistan (Da Afghanistan Bank) and Financial Intelligence Unit of Korea for exchanging of information relating to suspicious transactions.
- (ii) **Institutional Capacity Building and Awareness Programmes :** Fifteen training and awareness programmes were conducted in Western, Central, North Central and Southern Provinces during the year accommodating more than 2,300 participants representing LCBs, LSBs, RFCs, Police Department, educational institutions and general public on analyzing, detecting, and reporting money laundering and terrorist financing transactions.
- (iii) **International Relations**
 - a) **Egmont Group :** Egmont Group is an association of Financial Intelligence Units (FIUs) established in June 1995 to enhance the mutual co-operation and to share information in detecting and combating money laundering and terrorist financing among the member countries. In line with the application submitted by Sri Lanka for Egmont membership in 2006, the Observer Status was received in 2008. The member status is expected in 2009.
 - b) **Asia Pacific Group on Money Laundering :** Sri Lanka as a member country of Asia Pacific Group on Money Laundering (APG) attended its 11th Annual Meeting held in Indonesia in July 2008. Further, the FIU hosted the 11th APG Annual Typologies Workshop in Colombo during 27th - 29th October 2008 to discuss various new methods, strategies and trends of worldwide money laundering and financing of terrorism and attended by 84 foreign delegates from 29 countries and 41 participants representing Sri Lanka.

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 propose 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, specialised banks, finance companies, leasing companies, primary dealers, insurance companies and brokers, stock brokers, unit trusts, 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 analyse 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 evaluates 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 compiles a Banking Stability Index (BSI) to monitor overtime the aggregate soundness of the banking sector. The BSI is compiled from indicators relating to capital levels, profitability, asset quality, liquidity and asset liability mismatches. In addition, the FSSD also conducts regular stress tests on bank portfolios to gauge potential exposure to credit, market and liquidity risks in the face of extreme events or market conditions.

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 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 through the FSSD to the Monetary Board on financial system stability issues.

12. HUMAN RESOURCES MANAGEMENT

Human resources management of the Bank was further improved in 2008 through amalgamating training function with Human Resources Department (HRD). The major functions carried out by HRD in 2008 included recruitments, performance management, promotions, training and development and job rotations in line with the human resource needs identified by the Bank in its Strategic Plan.

12.1 Human Resource Structure

As at the end of 2008, total staff of the Bank was 1,304 consisting of 554 staff class officers, 538 non staff class officers, 150 minor employees and 62 contractual employees. The average age of the staff was 43 years. As indicated in table II - 8, nearly 85 percent of employees in the staff officer category had first degree or higher academic qualifications. During 2008, 27 employees retired and 13 employees resigned from the Bank service.

12.2 Recruitment

In 2008, HRD placed a high priority for new recruitments to fill the identified competency gaps. Accordingly, 123 Banking Assistants, 16 Drivers and 63 Minor Employees were recruited. In addition, considering technical competency requirements of several departments, actions were taken to recruit a Systems Manager, 3 Software Developers, 3 Fund Managers and 6 IT Technicians (Trainee) in 2008. Further, 4 female Security Officers, a Petroleum Geologist and one officer to the Financial Intelligence Unit were recruited on contract basis. HRD also facilitated the recruitments of 7 Junior Executive Officers to Poverty Alleviation Micro Finance Project II (PAMP II) handled by the Regional Development Department.

12.3 Performance Management System

The Performance Management System of the Bank has been designed to link the activities of all individual officers with the Bank's vision and mission. At the beginning of the year, the Performance Evaluation process begins with the employees setting their own goals with appropriate weight for the goal, in consultation with the supervisor. Based on those goals, the employees complete the self-evaluation section of the performance evaluation form by giving a performance rating for each goal.

The performance evaluation discussion is held between the employee and the supervisor in order to arrive at a final performance rating. The overall ratings given by the supervisors are reviewed by the respective Head of the Department and the Management to maintain a standardized rating structure. In addition, the employee submits the learning, training and career development plans along with the performance evaluation form to the supervisor for their assessment.

Performance evaluation for the year 2007 for all employees was completed successfully during 2008. Individual and departmental goal setting for the year 2008 was also carried out concurrently as per the time targets set out at the beginning of the year.

12.4 Promotions

Career progression of the employees was ensured through granting due promotion on time. The number of years in service, performance evaluation rating and the recommendations given by the Heads of Department were used as the evaluation criteria for promotions. A total of 177 staff members were given their grade, class and position promotions in 2008. On this basis, 22 Deputy Heads of Department were promoted to Staff Class Grade IV as Acting Additional Heads of Department while one Deputy Head of Department was promoted to Staff Class Grade IV as a Head of Department. Further, 22 Staff Class Grade III officers were designated as Deputy Heads of Department. In addition, 22 Personal Assistants in Non Staff Class Grade IV and V were promoted to Staff Class Grade I.

Table II- 8
Human Resources Structure as at 31.12.2008

Categories of Employees	No. of Employees			Average Age	Educational / Professional Qualifications					
	Male	Female	Total		Post Graduate, First Degree & Professional Qualifications	Post Graduate & First Degree	Post Graduate & Professional Qualifications	First Degree & Professional Qualifications	First Degree	Professional Qualifications
(1) Staff Class										
(i) Grade IV and above	45	14	59	52	07	39	02	04	07	0
(ii) Grade III	82	28	110	50	13	57	01	03	36	0
(iii) Grade II	46	37	83	45	06	19	01	10	35	0
(iv) Grade I (Including Management Trainees)	135	167	302	41	02	22	02	27	167	08
(2) Non Staff Class										
(i) Grade V	31	71	102	54	0	0	0	0	32	0
(ii) Grade IV	61	51	112	48	0	0	0	0	07	02
(iii) Grade III	87	20	107	48	0	0	0	0	06	03
(iv) Grade II (Including Banking Assistants)	110	77	187	32	0	0	0	0	01	01
(v) Grade I	29	01	30	43	0	0	0	0	0	0
(3) Minor Employee Class										
(i) Grade I, II and III	143	07	150	36	0	0	0	0	0	0
(4) Contractual Employees										
(i) All Categories	51	11	62	40	0	06	0	0	0	0
Total	820	484	1304	43	28	143	06	44	291	14

12.5 Training

The training in 2008 was focused towards developing a multi-skilled staff. HRD completed an exercise to identify existing competency gaps in all departments with the intension of filling the identified gaps through providing specific trainings. The training opportunities accordingly provided included short-term programmes such as seminars, workshops, conferences and training programmes conducted locally as well as abroad and post-graduate studies. 1,712 such training opportunities were provided during the year.

a) Foreign training

In 2008, the Bank provided opportunities for 150 officers to participate in a wide range of foreign training programmes, seminars and conferences conducted by reputed training institutions abroad.

With a view to imparting knowledge gained through foreign training programmes among fellow officers, the officers who participated in training programmes were requested to conduct regular seminars in the Bank. Accordingly, 33 seminars were conducted on Wednesdays and Thursdays. Further, in order to encourage the officers to utilize the knowledge gained through participating short-term training, a training sub committee consisting of three Assistant Governors and DHR was appointed to monitor the progress of special assignments agreed by the officers.

Table II - 9
Short Term Foreign Training Opportunities - 2008

Field	No. of Participants
Economic and Economic Policies	40
Financial System and Regulations	18
Risk Management	15
Finance	19
IT and Payment Systems	15
Public Debt Management	12
Central Banking	09
Human Resources Management	13
Other	09
Total	150

b) Post-graduate studies

The Bank, as in the past, continued to provide facilities for its staff to acquire post-graduate qualifications both Master's and Ph.D. Degrees from recognized universities in UK, USA, Canada, Japan and Australia under its Scholarship Scheme. With a

view to enhancing intellectual capacity in the Bank, the existing criteria on post-graduate studies were revised in 2008 to give more opportunities for officers to obtain post-graduate qualifications. Accordingly, 04 officers were given the opportunity to commence Ph.D. Degree programmes while 05 officers commenced Master's Degree Programmes in 2008. After successful completion of Master's Degree Programme, 04 officers resumed duties in 2008.

c) Local training

In 2008, the Bank provided 1,562 opportunities for officers to participate in training programmes conducted by Centre for Banking Studies (CBS) and other recognized training institutions locally. In providing local training, the priorities were given to enhance knowledge in the areas of information technology, communication, financial and capital markets, bank supervision, macro economic analysis, internal auditing, general management etc. In addition, orientation programmes for 59 Management Trainees and 123 Banking Assistants were arranged in 2008. The Bank also formed a Toastmasters' Club with 50 officers with a view to enhancing communication and presentation skills of the officers.

12.6 Job Rotation

With a view of developing a multi-skilled staff and enhancing overall productivity of the Bank, employees who served for more than five years in one department were transferred to another department considering the competency level of the officers and competency requirements of the various departments. Under this programme, a total of 98 staff members were rotated in 2008.

12.7 Employer – Employee Relations

HRD facilitated the maintenance of a close dialogue between the Trade Unions and the Management during the year. The Trade Unions were given the opportunity to meet the Management to discuss issues as and when necessary. Accordingly, during the year, 6 discussions were held. The dialogue facilitated the management to resolve a number of issues relating to recruitment, promotions, training, welfare and general administration.

Meetings Attended by the Governor

1. To attend the Global Summit on Management Accounting in India, in January.
2. To participate in the Asset Best Sovereign Bond Award Ceremony held in Hong Kong, in January.
3. To meet the Governor, Bank Negara Malaysia, in January.

4. To attend a Meeting with Hon. Minister of Finance in Darussalam, Brunai, in January.
5. To meet investors in London and to discuss the performance of the Sri Lankan economy, in February.
6. To deliver an address at the 2nd World Management Summit 2008 in Karachi, Pakistan, in March.
7. To attend the 43rd SEACEN Governors' Conference and 27th Meeting of SEACEN Board of Governors in Jakarta, Indonesia, in March.
8. To attend the IMF/ World Bank Spring Meetings in Washington, D.C., USA, in April.
9. To attend the Commonwealth Heads of Government Preparatory Meeting in London, in June.
10. To attend the 37th Meeting of the Board of Directors of the Asian Clearing Union in Nay Pyi Taw, Myanmar, in June.
11. To attend meetings with investors in Dubai and Abu Dhabi and to discuss the performance of the Sri Lankan economy, in June.
12. To attend the SEANZA Governor's Symposium and Meeting in Bangkok, Thailand, in September

PROMOTIONS/APPOINTMENTS

- 1.) Mr. S. Abeysinghe, Secretary to the Ministry of Finance and Planning became a member of the Monetary Board, being the person holding office of Secretary to the Ministry of Finance and Planning, with effect from 23 September 2008.
- 2.) The following promotions and appointments were made effective from 03 July 2008.
 - I.) Mr. P. G. Jayasooriya was promoted and appointed as Acting Additional Director of the Regional Development Department.
 - II.) Mr. H. M. Ekanayake was promoted and appointed as Acting Additional Director of the Security Services Department.
 - III.) Mr. G. D. Gunaratna was promoted and appointed as Acting Additional Superintendent of the Currency Department.
 - IV.) Mr. K. D. Ranasinghe was promoted and appointed as Acting Additional Director of the Economic Research Department.
 - V.) Mr. D. M. Rupasinghe was promoted and appointed as Acting Additional Director of the Financial Intelligence Unit.
 - VI.) Mrs. S. Gunaratna was promoted and appointed as Acting Additional Director of the Economic Research Department.
 - VII.) Mr. M. J. S. Abeysinghe was promoted and appointed as Acting Additional Director of the Statistics Department.
 - VIII.) Mrs. R. A. S. M. Dayarathna was promoted and appointed as Acting Additional Director of the Information Technology Department.
 - IX.) Mrs. K. Gunatilleke was promoted and appointed as Acting Additional Superintendent of the Employees' Provident Fund Department.
 - X.) Mr. U. H. E. Silva was promoted and appointed as Acting Additional Superintendent of the Employees' Provident Fund Department.
 - XI.) Mr. K. P. N. S. Karunagoda was promoted and appointed as Acting Additional Director of the Centre for Banking Studies.
 - XII.) Mr. P. V. L. Nandasiri was promoted and appointed as Acting Additional Chief Accountant of the Finance Department.
 - XIII.) Mrs. T. M. J. Y. P. Fernando was promoted and appointed as Acting Additional Director of the Bank Supervision Department.
 - XIV.) Mr. S. J. A. Handagama was promoted and appointed as Director of the Communications Department.
 - XV.) Mr. D. A. G. K. Wijetunga was promoted and appointed as Acting Additional Director of the Domestic Operations Department.
 - XVI.) Mr. J. P. R. Karunaratne was promoted and appointed as Acting Additional Secretary of the Secretariat Department.
 - XVII.) Mr. A. R. K. Wijesekera was promoted and appointed as Acting Additional Director of the Human Resources Department.
 - XVIII.) Mr. C. N. Wijayasekera was promoted and appointed as Acting Additional Superintendent of the Public Debt Department.
 - XIX.) Mr. P. W. D. N. R. Rodrigo was promoted and appointed as Acting Additional Director of the Policy Review and Monitoring Department.
 - XX.) Mr. A. A. M. Thassim was promoted and appointed as Acting Additional Director of the Bank Supervision Department.
 - XXI.) Mr. R. J. Perera was promoted and appointed as Acting Additional Director of the Premises Department.
 - XXII.) Mr. F. C. S. Mendis was promoted and appointed as Acting Additional Director of the Management Audit Department.

- XXIII). Mr. P. H. O. Chandrawansa was promoted and appointed as Acting Additional Director of the Department of Supervision of Non-Bank Financial Institutions.
- 3.) Mr. U. P. Alawattage, Addl. Controller of the Exchange Control Department, was appointed as Additional Director of the Centre for Banking Studies with effect from 20 April 2008, as Acting Director with effect from 01 May 2008 and as Director with effect from 01 November 2008.
 - 4.) Dr. W. M. Hemachandra, Director of the Centre for Banking Studies, was appointed as Special Officer of Policy Review and Monitoring Department with effect from 01 May 2008. Subsequently, he was appointed as Director of the Policy Review and Monitoring Department with effect from 24 July 2008.
 - 5.) Mr. S. S. Ratnayake, Acting Director of the Department of Supervision of Non-Bank Financial Institutions, was appointed as Director of the Department of Supervision of Non-Bank Financial Institutions with effect from 10 May 2008.
 - 6.) Mr. B. D. W. A. Silva, Acting Director of the Bank Supervision Department, was appointed as Director of the Bank Supervision Department with effect from 03 June 2008.
 - 7.) Mr. S. Lankathilake, Acting Director of the Human Resources Department, was appointed as Director of the Human Resources Department with effect from 03 June 2008.
 - 8.) Mr. C. J. P. Siriwardena, Acting Superintendent and Registrar of the Public Debt Department, was appointed as Superintendent and Registrar of the Public Debt Department with effect from 03 June 2008.
 - 9.) Mr. E. A. Hettiarachchi, Additional Director, who was on No-pay leave, was appointed as Acting Controller of the Exchange Control Department with effect from 21 July 2008.
 - 10.) Mrs. S. N. Perera, Acting Director of Welfare Department, was appointed as Director of the Welfare Department with effect from 22 July 2008.
 - 11.) Mr. D. Wasantha, Controller of Exchange, was appointed as special officer of Employee's Provident Fund Department with effect from 21 July 2008 and subsequently as Superintendent of the Employees' Provident Fund Department with effect from 24 July 2008.
 - 12.) Mrs. J. P. Mampitiya, Director of the Information Technology Department, was appointed as Director of the Payments and Settlements Department with effect from 18 August 2008.

- 13.) Mrs. R. A. S. M. Dayaratne, Acting Additional Director of the Information Technology Department, was appointed as Acting Director of the Information Technology Department with effect from 18 August 2008.
- 14.) Mr. J. P. R. Karunaratne, Acting Additional Secretary of the Secretariat Department, was appointed as Acting Additional Director of the Department of Supervision of Non-Bank Financial Institutions with effect from 26 December 2008.

RETIREMENTS

- 1.) Dr. P. B. Jayasundara, a distinguished economist and administrator, who guided the Central Bank to maintain the highest level of professionalism, ceased to function as a member of the Monetary Board with effect from 23 September 2008 upon his resignation as the Secretary to the Ministry of Finance and Planning.
- 2.) Mr. Y. M. W. B. Weerasekara, Assistant Governor, retired from the Bank service with effect from 14 January 2008.
- 3.) Mr. R. A. Jayatissa, Assistant Governor, who was released to the Ministry of Finance as a Deputy Secretary to the Treasury and Senior Economic Policy Advisor, retired from the Bank service with effect from 21 November 2008.
- 4.) Mr. M. V. M. Fernando, Director of Welfare Department, retired from the Bank service with effect from 22 January 2008.
- 5.) Mrs. P. P. Sirisena, Director of Training Department, retired from the Bank service with effect from 04 February 2008.
- 6.) Mrs. J. A. N. Dissanayake who was released as the Secretary to the Presidential Commission of Inquiry to Investigate into Matters Relating to Failed Finance Companies, retired from the Bank service with effect from 19 February 2008.
- 7.) Mr. H. M. P. Herath, Additional Director of Premises Department, retired from the Bank service with effect from 25 February 2008.
- 8.) Mrs. K. R. M. Siriwardhane, Director of Payments and Settlements Department, retired from the Bank service with effect from 16 August 2008.
- 9.) Mr. M. M. Attanayake, Director of Policy Review and Monitoring Department, retired from the Bank service with effect from 10 September 2008.
- 10.) Mr. A. Jeewandara, Superintendent of Currency Department, retired from the Bank service with effect from 26 September 2008.

- 11.) Mr. L. Y. Dharmasena, Superintendent of Employees' Provident Fund Department, retired from the Bank service with effect from 09 October 2008.

OFFICERS ON RELEASE/LEAVE

- 1.) Mr. K. G. D. D. Dheerasinghe, Assistant Governor, to the International Monetary Fund as an Alternate Executive Director.
- 2.) Mr. J. P. R. Karunaratne, Acting Additional Director of the Department of Supervision of Non-Bank Financial Institutions, to the Ministry of Defence, Public Security, Law & Order (on part time basis).
- 3.) Mr. S. R. Attygalle, Deputy Head of Department, to the Ministry of Finance and Planning.
- 4.) Ms. K. G. R. K. Dheerasinghe, Deputy Head of Department, to the Ministry of Finance and Planning.
- 5.) Mr. B. Lokuranamuka, Staff Class Grade III officer, to the Ministry of Finance and Planning.
- 6.) Mrs. T. M. R. P. Yatigammana, Staff Class Grade II officer, to the Ministry of Finance and Planning.
- 7.) Mr. H. P. M. Wasantha Kumara, Staff Class Grade II officer, to the Ministry of Finance and Planning.
- 8.) Mr. M. Mahinda Saliya, Staff Class Grade II officer, to the Ministry of Finance and Planning.
- 9.) Mrs. D. G. D. I. Ekanayake, Staff Class Grade I officer, to the Ministry of Finance and Planning.
- 10.) Mr. E. W. K. J. B. Ehelapola, Staff Class Grade I officer, to the Ministry of Finance and Planning.
- 11.) Mr. K. A. U. S. K. Thilakarathne, Staff Class Grade I officer, to the Ministry of Finance and Planning.
- 12.) Mrs. D. K. Uyangodage, Staff Class Grade I officer, to the International Monetary Fund.
- 13.) Mrs. H. M. N. S. Gunawardena, Legal Officer (contract), to the Ministry of Finance & Planning.
- 14.) Mrs. R. Dheerasinghe, Staff Class Grade IV officer, on No-pay Leave.

13. INFORMATION TECHNOLOGY

Main focus of the IT department during the year was to act as a business enabler introducing innovative solutions for the Bank operations deviating from its traditional role of a service provider. Consequently, the major tasks of the Department is organized in four (4) themes, to achieve the objective of acting as a business enabler.

1. Development and maintenance of business projects

2. IT Risk Management
3. IT infrastructure Developments
4. Act as an advisor to the financial/ public sector

13.1 Development and maintenance of business projects

While attending to maintenance of the existing applications, the Department introduced user friendly, secure and interactive web solutions for achieving Bank's core objectives and carrying out agency functions in the areas of Exchange Control, Employees Provident Fund, Management of Public Debt, Combating Terrorist Financing and Anti-Money Laundering.

Accordingly, the integrated project development concept that was introduced in 2007 was extended to

- a) The Exchange Control Department to implement '**ForexNet**', a new web application to collect data on Foreign Exchange Sales and Purchases from foreign exchange dealers
- b) The Financial Intelligence Unit to analyze/report suspicious and cash transactions that are submitted by commercial banks through '**LANKA FIN**' system
- c) The Public Debt Department to settle overnight repo reversals as a batch data transfer and to introduce a new reporting mechanism for primary dealers
- d) Domestic Operations Department and Economic Research Department to collect and report money market rates from commercial banks and primary dealers

Further, software development is in progress for a web based liquidity monitoring system for DOD, and foreign exchange transaction monitoring system for IOD. Existing secondary market trading system was modified in order to pledge central bank securities as collateral in open market operations with the Bank.

An electronic policy library was implemented for the Bank during the year using Domino Document Manager after extensive research and development work.

IT Department continued the maintenance of Employees' Provident Fund system and was able to achieve almost 100 per cent system availability throughout the year. EPF web site was expanded with the objective of supplying wider services to both members and employees. In view of the wide coverage in the use of mobile telephones, a new SMS based member information access service was

launched during the year utilizing the mobile phone communication channels. Software development for the Re-engineering of EPF internal operations commenced during the year. The objective of the re-engineering process is to improve the current business processes by means of enhancing efficiency and effectiveness by greater integration among different sub-systems. To expedite the EPF-Housing Loan granting facility, ITD introduced a decentralized Housing Loan certificate issuing system and also developed a system to facilitate EPF beneficiaries to invest their EPF refunds in government securities.

A major milestone during the year was the introduction of a job costing system for all software development projects and IT services supplied by the department. Accordingly, on completion of the system study or provision of the required services, IT department has submitted the project/ service cost to client departments.

13.2 IT Risk Management

One of the major responsibilities of the IT Department was to maintain the systemically important payment systems and related interface software to ensure maximum availability for real time settlement of transactions. As at 31st December 2008, the ITD has been able to achieve an uptime of 99.6 per cent for the Payment systems.

The intrusion prevention system installed at the Bank network gateway was further strengthened to detect and prevent the hacking attempts to the Bank IT systems. Since the threats to IT security cannot be mitigated by technological solutions alone, the institutional information security policy was reviewed and updated.

Further, to strengthen the information security awareness among the Bank staff, a security booklet was prepared in all 3 languages.

Business Continuity Plan (BCP) of the Bank was updated during the year and 2 BCP drills were conducted from the Disaster Recovery Site (DRS) with the participation of Lanka Settle participants, foreign counter parts and internal departments. During the SAARC summit period in July 2008, Bank operations were conducted from the remotely located DRS for a continuous period of 5 days. To enhance the awareness of BCP, all relevant staff members will be distributed a leaflet prepared by the department very soon. ITD officers actively participated in BCP inspection reviews of Lanka Settle participants.

As CBSL functions are carried out in a pre-dominantly automated environment, a rapid response to user queries has become very critical. An IT Help

Desk operational from 0700h to 1830h fulfills their critical requirements. To record, monitor and respond to the IT incidents and help desk queries, an in-house developed application, Issue tracker was implemented.

13.3 IT Infrastructure Developments

The Central Bank wide area network (CBSLNET) which is connected to the Treasury offices of banks and primary dealers was administered to provide the expected services to the financial sector. During the years, arrangements were finalized to transfer the maintenance cost of leased lines which was earlier borne by CBSL to participating institutions. Further, strengthening of the CBSL LAN was continued by installing IS appliances such as firewalls and Intrusion Detection/Prevention systems. The Internet line capacity was expanded to 2Mbps considering the high demand for web browsing to promote knowledge culture and make information backed decisions, address the need for having a faster dedicated line for financial institutions to access the Bank's web applications for regulatory reporting purposes. Head office to DRS connectivity was upgraded to 4 mbps using a metro Ethernet connectivity to attain the high availability and fast data transfer between HO and DRS.

The resilience of the systems was further improved during the year by upgrading the replication software and the operating systems.

SWIFT works as the financial messaging network for RTGS and foreign exchange payments. SWIFT embarked on a project to upgrade its technology and security. The project had two phases. SWIFTNet phase II was completed during the year enabling the Bank to use improved security and services of SWIFTNet. Further, the secondary SWIFTNet connection of the Bank DR site was changed from Direct Connectivity to an Indirect Connectivity through the SWIFT Service Bureau of Sri Lanka, which was formed by Sri Lanka SWIFT user group to save cost of connectivity to SWIFT.

13.4 Act as an advisor to the financial/ public sector

The Department continued its advisory service and technical assistance to the projects of national interest. The contribution of the department in evaluating technical proposals to select a suitable solution and introduction of a certification authority for financial transactions was very significant in implementing the Sri Lanka Common Payment Switch which will be the real time retail payment system of the country from 2009.

IT staff actively participated in conducting electronic media contribution collection promotional presentations and workshops for EPF and labor department and provided necessary technical support for the EPF Re-registration project.

The Department engaged in continual update of ICT competencies among the CBSL staff as well as the staff of financial institutions by releasing officers to the Bank's Centre for Banking Studies as resource persons and conducting internal training/awareness sessions for departmental liaison officers.

14. INTERNATIONAL OPERATIONS

International Operations Department (IOD) is entrusted with the responsibility of managing the official foreign exchange reserves of the country which are maintained, as required by the Monetary Law Act to facilitate maintenance of external stability of the Sri Lanka rupee and to assure the maximum possible freedom of the country's international transactions. At the same time, department also monitors the domestic foreign exchange market to ensure its smooth operations.

14.1 Foreign Exchange Reserve Management

The year 2008 was a challenging year for global investors. The global financial sector experienced unprecedented challenges starting in 2007 with the sub prime mortgage crisis and created profound spillover effects to the rest of the global economy. As a result, prospects for global growth have deteriorated and financial markets experienced unprecedented problems. This in turn together with energy crisis and food crisis caused recessionary fears across most major economies in 2008. Most of the commercial banks worldwide during this year were down graded. The financial market turmoil continuously threatened the world interest rates as well as asset prices resulting in drastic decline in commodity prices except gold. Widespread reluctance to lend resulted from bank and financial failures in major financial markets significantly constrained the foreign currency credit lines available to commercial banks and other financial institutions. This liquidity and credit crunch developed in the international market has also resulted in the withdrawal of foreign holdings on Sri Lanka Treasury bills and bonds creating an added pressure on the exchange rate of the Sri Lanka Rupee. As such, the reserves management was a challenging task during the year 2008.

Investments of foreign exchange reserves were done in accordance with the Foreign Exchange Reserve

Management guidelines approved by the Monetary Board, under the supervision of the Foreign Reserves Management Committee (FRMC). The foreign exchange reserves which consisted of currencies such as US Dollars, Euros, Sterling Pounds, Australian Dollars and gold were invested mainly in two asset classes namely, Fixed Income Securities and money market instruments. Bank's Fixed Income Securities portfolio consisted of highly rated sovereign government securities, government guaranteed securities, and securities of government agencies and supranational institutions. The transactions on investments on both fixed income securities and money market were performed only through highly rated and approved counter parties within the limits structure approved by the management, paying due consideration to safety, liquidity and return on such assets. Liquidity requirements of the Bank, debt service repayments, risk management parameters, income generating abilities and specific directions of the Monetary Board were the key issues considered in determining the asset and currency composition of the reserves portfolio.

In order to reduce the exposure to any sudden increase in credit risk, investments held with commercial banks were withdrawn and reinvested with Central Banks and BIS (Bank for International Settlement). Liquidity requirements were fulfilled by maintaining a sufficient proportion of reserves in highly liquid short-term instruments of both asset classes.

Nevertheless, the Bank's overall reserve management operations have generated a net foreign income of US\$ 153 million or Rs. 16,687 million during the year 2008, exceeding the budgeted income of US\$ 118 million and the income of the previous year amounting to US\$ 125 million. In the midst of comparatively lower interest rates prevailed in major economics, capital gains on fixed income securities contributed to the increase in income.

14.2 Risk Management

The risks associated with the foreign exchange reserves and their investments are monitored continually by the Middle Office of the IOD. The foreign exchange reserves and their investments are exposed to various categories of risks. Among these risk categories, foreign exchange risk, interest rate risk, credit risk, liquidity risk and operational risks are considered as major components. Foreign exchange risk or the risk of capital loss as a consequence of fluctuations in exchange rates is managed mainly through diversification of investment currencies. Interest rate risk or the exposure of the Bank's reserves portfolio to

movements in interest rates was managed through the appropriate adjustment of the duration of the portfolio. Counterparty Credit Risk Management System (CCRMS) is used by the IOD to manage the credit risk. The liquidity risk, which is the risk of incurring capital losses in the event of forced liquidation, is managed by establishing liquidity requirements and maintaining sufficient proportion of assets in highly liquid form. The operational risk resulting from human error, flawed systems and inadequate procedures and controls were managed through a range of measures.

Appropriate precautionary measures such as diverting money market investments to central banks and timely eliminating of exposure to foreign commercial banks, limiting trading activities during highly volatile market conditions, strengthening the monitoring and evaluation of credit and liquidity risk were adopted by the IOD to mitigate the adverse impact caused through the global financial crisis.

14.3 Monitoring the Domestic Foreign Exchange Market Developments

The activities of monitoring domestic foreign exchange market, mainly the foreign exchange transactions and overnight net foreign exchange positions of commercial banks were continued during the year 2008 by the department with a view of promoting the smooth functioning of the domestic foreign exchange market and to ensure an orderly adjustment of the exchange rate of the Sri Lanka rupee.

Further relaxation of foreign investments in Sri Lanka Government securities has resulted in increased foreign exchange inflows and pressurized on the exchange rate during the first eight months of the year. In order to prevent appreciation of Sri Lanka rupee and the resultant negative impact on the economy, exports, imports, etc. the Central Bank purchased excess foreign exchange from the domestic foreign exchange market, which totaled US dollars 674 million. However, the situation changed due to the global financial crisis since September 2008. The CBSL had to intervene in the domestic foreign exchange market to smooth-out excessive fluctuations created due to sudden outflow of foreign exchange during the last four months of the year. Withdrawal of foreign holdings on Sri Lanka Government Treasury bills/bonds and the settlement of the petroleum import bills on purchases made at comparatively higher price levels falling due in the last quarter of the year contributed towards significant foreign currency outflows. As such, the CBSL

injected US dollar 1532 mn to the domestic foreign exchange market during the year 2008.

The exchange rate of Sri Lanka rupee had shown a depreciation of 3.91 percent during the year 2008 against the US dollars. It moved from rupees 108.71 per US\$ at the end of 2007 to 113.13 per US\$ at the end of 2008.

The volume of inter-bank foreign exchange transactions increased to US dollars 14,132 million in 2008 from US dollars 9,275 million in 2007 recording a significant growth of 52.36 per cent during the year 2008.

Further, the department revised the permitted net open foreign exchange exposure positions of commercial banks in 2008, aimed at controlling the level of speculative transaction volume that threaten the smooth operations of the domestic foreign exchange market. The process of providing exchange rates information of Sri Lanka rupee against other foreign currencies to Government Departments and Corporations, local and foreign agencies and other parties continued during 2008.

served an efficient catering service was provided with available staff.

A series of lectures on various topics such as health and general topics were conducted by the department for the benefit of the staff in 2008. Also useful health tips were circulated by using electronic media.

Table II - 10
Inter-Bank Foreign Exchange Transactions
Volume – 2008

(US \$ mn)

Months	Spot	Tom	Cash	Forward	Total
January	552	150	95	476	1,273
February	398	127	138	414	1,077
March	451	95	160	389	1,094
April	409	269	177	375	1,230
May	331	140	140	387	998
June	306	256	101	434	1,097
July	417	210	187	602	1,416
August	292	170	106	542	1,110
September	393	231	138	556	1,318
October	826	169	120	768	1,883
November	391	139	87	298	915
December	306	108	75	231	720
	5,070	2,064	1,526	5,472	14,132

Table II - 11
Monthly Summary of CBSL
Absorption and Supply of Foreign Exchange – 2008

(US \$ mn)

Months	Absorption	Supply	Net
January	136	24	112
February	160	7	153
March	95	14	81
April	57	136	-79
May	5	47	-42
June	31	51	-20
July	124	0	124
August	14	36	-22
September	0	203	-203
October	0	588	-588
November	0	266	-266
December	53	160	-108
	674	1,532	-858

15. LEGAL

During the year 2008, the Legal Department continued supporting the Bank in achieving its objectives. The nature of this support was in the form of formulation and implementation of policy, preparation of legislation as well as subsidiary legislation and asserting and defending the rights of the Bank before courts and other legal fora.

The Department actively took part in preparation of laws in relation to banking, deposit insurance and company revival and restructuring. Several by-laws in the area of financial system stability and, in particular, those on corporate governance and payment devices were prepared with the assistance of the Legal Department.

The year 2008 became a particularly challenging year in view of the large number of cases filed against the Bank on the validity of prudential requirements introduced. This challenge was successfully met by the Bank with a proactive approach towards the ultimate objective of greater public interest. In most cases, judicial pronouncements were obtained upholding the need for effective regulation of financial institutions.

16. MANAGEMENT AUDIT

The Department of Management Audit carried out its internal audit and management services in 2008 with the objective of facilitating the Bank to achieve the targets set in the Strategic Plan 2008 by making recommendations to improve the operations and system of controls of the Bank through a risk based audit approach. The Department also served as the Secretariat to the Audit Committee of the Monetary

Board and Bank-wide Risk Management Committee of the Bank.

In accordance with the Audit Plan 2008, the department carried out several audit assignments to ensure the adequacy of the internal controls in place, while continuing the compliance audits to verify the adherence to the determined controls. As such, some internal audits were carried out based on the risk assessment of the departments and also few individual audit assignment programmes were prepared by giving more attention to the risk levels. As in previous years, follow-up audit reviews were also carried out to ascertain the level of the implementation of audit recommendations.

The Management Audit Department completed most of the audits in Audit Plan 2008 and also completed all the pre-audits related to Secretariat Department and Welfare Department. Compliance audits related to Human Resources Department and Secretariat Department were also completed successfully.

The Department also carried out several special assignments by allocating more resources on high and moderate risk operation areas to ensure the effectiveness of the functions and procedures of the relevant departments. In this regard, the department completed audit in Business Continuity Plan (BCP), Access Control System and Security Camera System of the Bank and the Logical Access on Oracle administration of the Finance Department. Some of other important reports are Fail Over Test in DR Site, Pricing Policy of Services of Circuit Bungalows, audits done in Regional Development Department (RDD) for Financial Statements of Tea Development Project Revolving Fund (TDPRF) 2007, Review of Post Claim Recovery Process of Credit Guarantee Schemes, Effectiveness of Systems under Poverty Alleviation Microfinance Project (PAMP), Control over Expenditure at Printing Press, Review of adherence to Counter Party Limits, Dealer Limits and Currency Limits, Review of the Implementation of the Capital Expenditure Budget by Secretariat Department, Asian Clearing Union (ACU) transactions at Payments and settlements Department (PSD), Limits imposed on reserve management activities of International Operations Department (IOD) and Overall review of activities related to Service Agreements of Secretariat Department. Moreover, Audit paid high attention and commenced IS Audits to ensure the effectiveness of the software systems in operation within the Bank and commenced to study the system at RDD and conducted few Information System audit assignments with a limited scope.

During 2008, the Department gave priority to process audits and was able to identify a considerable number of issues relating to procedures. These observations and audit recommendations were reported to relevant departments and also to the Governor and the Audit Committee regularly. During the second half, these reports were submitted to the Monetary Board for its information.

During 2008, the Management Audit Department continued to upgrade the Bank-wide risk management system. Awareness Programmes to enhance the knowledge of Risk Officers in risk management were continued to be conducted by the Department. The manual risk incident reporting system also continued during the year and action was taken to determine the departmental risk tolerance levels too, continuously.

The Department prepared a comprehensive report on Foreign Reserves and submitted to the Governor for its information with recommendations on careful reserve management.

The Department planned to purchase an Audit Command Language (ACL) software package to uplift the process within the Department and procurement is now in progress. Two officers were given with a special training in this area with the objective of perform better in 2009.

The Department took measures to train the staff in audit and audit related activities as a step forward to the capacity development of the Department.

17. PAYMENTS AND SETTLEMENTS

The Payment and Settlement Systems Act No. 28 of 2005 provides wide range of powers and authority to the CBSL for regulation of payment, clearing and settlement systems, disposition of securities on the books of the Central Bank, regulation of money service providers, electronic presentment of cheques and any kind of activity related to the payment and settlement systems in the country. The CBSL handles these operations through the Payments and Settlements Department (PSD). Accordingly, with the objective of achieving a safe, sound and efficient financial system which is capable of withstanding external and internal shocks in the financial system, the PSD continued its operations of the Real Time Gross Settlement (RTGS) system which is the systemically important large value payment and settlement system, the payment gateway for the Central Bank transactions that are effected through the LankaSettle system, back office functions to process and effect payment and settlement

instructions in respect of Central Bank's foreign exchange reserve management and Open Market dealings, handling and management of SWIFT transactions, facilitating trade and fund transfers through Asian Clearing Union (ACU) and policy formulation and oversight activities with regard to the payment and settlement systems in the country. In addition, the department facilitated the establishment of the SAARC Region's payment initiative and maintenance of SAARC Payment Initiative (SPI) Secretariat at the Central Bank.

17.1 Operating the Real Time Gross Settlement (RTGS) System

The RTGS Operations Division of PSD continued settlement of inter-participant payments in financial markets as well as their customer payments on real time gross basis and provided help desk services to participants throughout the operating hours of the system during the year 2008. The total volume of transactions settled by the RTGS system during the year was 228,654 with a total value of Rs.25,131 billion. RTGS recorded its highest volume of 1,515 transactions and value of Rs. 277 billion in a day during the year 2008. The average volume and value of transactions settled per day was 949 and Rs. 104 billion, respectively. CBSL has released around Rs.9.0 billion per day to the RTGS participants who requested extra funds to assure the smooth function of the system through Intraday Liquidity Facility (ILF).

Participants in the RTGS system consisted of CBSL, 22 LCBs, 8 non Bank primary dealer companies, Employees Provident Fund (EPF) and the Central Depository System (CDS) of the Colombo Stock Exchange. Standard Chartered Bank (Pakistan) Ltd was amalgamated with the Standard Chartered Bank Ltd and therefore, the total number of LankaSettle participants was 33 as at end 2008. As a performance indicator, RTGS Operations Division maintained the system availability of 99.65% during the year 2008. In order to ensure the readiness of the system in contingency events, several live operation sessions at DR site were completed successfully during the year, and each participant institution was encouraged to upgrade business continuity planning in their respective institutions, in line with directions issued by the CBSL. Meanwhile, considering the improvements in its operations through software enhancements, shut down time of the RTGS system was advanced from 5.15 pm to 5.00 pm with effect from 3rd November 2008. A PC based system was also implemented to operate the RTGS system during a disaster situation where both main and Disaster Recovery (DR) sites are not available.

17.2 Settlement of Deals under Foreign Exchange Reserve Management

Providing the Back Office functions for transactions carried out by the International Operations Department (IOD), the Forex, Gold and Foreign Securities Settlement Division of the PSD continued its activities on Treasury Dealing Room Management System (TDRMS). During the year 2008, the Division effected 7,049 settlement instructions amounting to USD 50.04 billion. The Division was also involved in updating the back office module of the TDRMS and signing related agreements with international organizations in order to facilitate requirements of the transactions.

17.3 Settlement of Transactions under Open Market Operations (OMO)

OMO Settlement Division is responsible for allocation of securities of CBSL portfolio, on behalf of the CBSL in OMO transactions with Participating Institutions. OMO Settlement Division effected 2,234 transactions on repo amounting to Rs.850 billion, 1,037 transactions on reverse repo transactions amounting to Rs.904.6 billion, 252 transactions on outright sales amounting to Rs.28.3 billion, 49 transactions on Outright Purchases transactions amounting to Rs.12.5 billion and 409 transactions on Central Bank Securities transactions amounting to Rs.176.7 billion.

PSD continued the provision of Intra-day Liquidity for participants and monitored the settlement of ILF. During the year 2008, Rs.2,189.2 billion were settled for 9,645 transactions under ILF.

17.4 SWIFT Communications

The SWIFT Communications Division of the PSD continued to perform the SWIFT related activities of CBSL and the following modifications were made to the system to be in line with the SWIFT development Road Map:

- Generated new RSA keys (Asymmetric Security Algorithm) and updated certificate for all logical terminals.
- Successfully finalized correspondent relationship management from Bilateral Key Exchange (BKE) to the new RMA application (Relationship Management Application) and completed SWIFTNet Phase 2.
- Updated SAA/SAE/RMA to Version 6.0.50.

In 2008, the total numbers of SWIFT messages sent and received by the CBSL were 1,206,408 and

794,075, respectively. Out of the received messages, 154,358 were related to Central Bank's own transactions. The balance was related to LankaSettle transactions.

17.5 Transactions under the Asian Clearing Union (ACU)

The total value of transactions of Sri Lanka effected through the ACU mechanism increased by 8 per cent from Rs.337 billion in 2007 to Rs.363 billion in 2008. This was mainly due to increased oil imports from Iran and high oil prices prevailed during the first 10 months of the year. The rupee value of net settlements made under the ACU mechanism during 2008 increased by 7 per cent and amounted to Rs.315 billion in 2008.

Table II - 12
Trade and ACU Transactions of Sri Lanka
with other ACU countries

	Rs. billion	
	2007	2008
Total transactions channeled through ACU	337.2	363.3
Sri Lanka's exports to other ACU countries	78.8	72.3
Sri Lanka's imports from other ACU countries	403.7	525.3
Sri Lanka's total trade with other ACU countries	482.5	597.6
Net ACU Settlement	293.5	315.2

Source: Central Bank of Sri Lanka

The 37th meeting of the Board of Directors of the ACU, which was held in Myanmar in June 2008, focused mainly on the recommendations made by the ACU Technical Committee chaired by the CBSL in February 2008. The Board of Directors unanimously approved the following recommendations:

1. Settlement of ACU transactions in either US dollars or Euros within the ACU mechanism and to maintain two separate accounting systems; one for transactions conducted in US dollar and the other one for Euro transactions in the ACU Secretariat.
2. To use dollar as a base currency for preparing Monthly Newsletter and Annual Report, as well as determining eligibility and entitlement for currency swap.
3. To apply the SDR cross rates quoted by the IMF as a reference rates.
4. To determine eligibility for currency swap on the basis of net deficit of ACU dollar and ACU euro accounts collectively-at the end of a settlement period.

5. To replace Barclay's Bank by British Bankers' Association as a reference rate of interest for currency swap.
6. To conduct seminars for commercial banks to enhance awareness about the ACU mechanism based on the materials prepared by the ACU Secretariat.

The ACU Secretariat amended the ACU Agreement and Procedure Rules, enabling member countries to implement approved recommendations effective from 1 January 2009. Accordingly, the CBSL issued Operating Instructions to commercial banks in December, 2008 on ACU mechanism under ACU dollar and ACU euro. Further, in order to educate relevant staff of all commercial banks on ACU mechanism, and to obtain feedback from them on current practices on ACU transactions, an awareness programme was also conducted by the PSD in December, 2008.

The Board of Directors of the ACU decided to hold the 38th ACU Board of Directors Meeting in Colombo, Sri Lanka in June 2009 and the Governor of the CBSL was elected as the chairman of the ACU for the year 2009. The preliminary actions were initiated by the PSD to facilitate the 38th ACU Board of Directors meeting.

17.6 Payment System Policy and Oversight

The Policy and Oversight Division of the PSD paid much attention on maintaining the reliability and reducing risks of systemically important payment and settlement systems (PSSs) during the year 2008, while continuing the routing oversight activities. Having considered the consequences of systemic risk, which would be caused by disruption of the PSS, the oversight activities were continued to focus on Business Continuity Planning (BCP) of participants in 2008. During the year, the Policy and Oversight Division evaluated the business continuity plans and DR arrangements of 22 Licensed Commercial Banks (LCBs) and 3 Primary Dealers, with the assistance of the officers from the Bank Supervision Department, Information Technology Department and Public Debt Department of the CBSL. The findings of the examinations were informed to the respective institutions for their comments and further improvements. The Department is expected to re-evaluate the improvements made to the BCPs and DR sites of the LCBs as per the Guidelines issued by the CBSL during 2009.

In order to ensure compliance to stipulated clearing and settlement time frame for the Cheque Imaging and Truncation (CIT) System, PSD issued a circular

to LCBs requesting them to maintain details of cheque submission/realization delays and inform to PSD on half-yearly basis. The LankaClear was instructed to report monthly the details of additional days requested by banks under CIT System.

Having realized that the efficiency expected through CIT system is diminished through the considerable number of cheque returns due to insufficient funds in respective accounts, the Central Bank issued a direction to prevent re-presentation of returned cheques due to non-availability of funds with the code of "Refer to Drawer" with effect from April 01, 2008 and to impose a penalty on banks for their dishonored cheques. Further, action has been initiated to conduct a customer survey with the assistance of the Statistics Department of the CBSL, in order to obtain a feedback from the customers point of view on adhering of LCBs to T+1 rule of the CIT System.

The Division involved in drafting regulations and directions to set out the minimum prudential requirements for all service providers of Payment Cards to foster the growth of the card based payments in safe, secure and efficient manner and to protect the interest of cardholders in Sri Lanka. These regulations and directions on payment cards are expected to be issued in 2009.

In addition to these activities, the Division also facilitated the establishment of the Lanka Financial Services Bureau (LFSB) to provide safe and economical SWIFT connectivity for participants which was completed in June, 2008 and a Common Payment Switch to assist real time retail fund transfers system which is scheduled to be implemented in 2009.

PSD continued to publish the quarterly Payment Bulletin in the Central Bank's web site during 2008. The staff of PSD conducted several programs to educate the general public and the banking community on CIT system and other related payment systems.

17.7 SAARC Payments Initiative (SPI)

In 2008, the department facilitated the establishment of SAARC Region's Payments Initiative (SPI) to collectively work towards establishing dynamic and coordinated working relationship among member countries. The inauguration of the SPI and the first meeting of the SAARC Payments Council (SPC) was held on March 28, 2008, in Colombo.

Under the aegis of the SAARCFINANCE Board of Governors, the SPC is responsible for managing the SPI. The SPC consists of 8 representatives from

central banks/monetary authorities of the SAARC region, nominated by the Governors of the SAARCFINANCE Group.

SPI Secretariat was established at the CBSL initially for a period of two years, to assist in administration, coordination work of the SPI such as organizing country studies and assessments, facilitating and designing and implementing specific technical assistance projects and helping member countries to upgrade their PSS to international standards and best practice.

At its first meeting, the SPC established its vision, mission, scope, objectives, and institutional framework, roles and responsibilities and Road Map for PSS developments, and all delegates also agreed to conduct a stocktaking exercise on their payments and settlements systems. SPI Secretariat presented the findings at the 2nd SPC meeting enabling members to understand the existing status of the PSS in the region, on a comparable basis. The 3rd SPC meeting was held on 29 September 2008 in Colombo. The SPI Secretariat published the first volume of SAARC Payments Bulletin and launched a website for the SPI at this meeting, in order to increase awareness on the progress of SPC and SPI, and PSS developments in member countries. An approach paper on Legal and regulatory framework for PSS prepared by the SPI Secretariat was presented at the 4th SPC meeting held in Pakistan on 20, December 2008. A pilot project was initiated to collect worker remittances within the SAARC region to evaluate the volumes of cross border payments.

18. POLICY REVIEW AND MONITORING

Policy Review & Monitoring Department (PRMD) undertakes (a) coordinating the strategic planning process and updating the Bank's strategic plan annually for the next five year period, (b) monitoring progress of departments on strategic plans, and (c) undertaking contemporary policy reviews and studies on current issues requiring new policies.

- (a) **Coordinating the strategic planning process:** PRMD organized a two-day Retreat with the participation of all heads of the departments, their representatives and senior management at Hotel Heritance Kandalama during 3 – 5 October 2008 to design and update the strategic plan for the period 2009- 2013. This strategic plan includes strategic objectives, goals, mechanism of achieving goals, outcomes, outcome indicators and departments responsible for achieving objectives and action plans under

different clusters, i.e., Economic and Price Stability, Financial System Stability, Currency Issues and Management, Agency Services, Human Resource Management and Development Services, Corporate Services and Policy Review and Monitoring.

(b) **Monitoring the activities of the departmental strategic plans.**

Pre-implementation sessions and quarterly monitoring of departmental performance were the two main aspects of the monitoring. PRMD arranged a series of cluster-wise awareness sessions on the Strategic Plan for the Bank's staff at the beginning of the year. Under the quarterly monitoring, progress of individual departments on the relevant action plans and the outcome was evaluated and reported to the Strategic Plan Review Committee (SPRC) which comprised of the corporate management of the Bank. The progress report included progress in maintaining of price stability, financial system stability and other major functions of the CBSL.

(c) **Policy Review and Studies**

PRMD prepared several review reports on interest rate policy, monetary and exchange rate policies, current global financial crisis and its impact on Sri Lanka, and public debt management. An on-line e-policy library to store soft copies of policy related documents was opened in December 2008 with the technical assistance of the IT Department. The e-policy library contains documents on legislation relating to operations of the CBSL, regulations, circulars and directions issued by the CBSL, and publications of the CBSL.

19. PREMISES

The Premises Department Continued to carry out the maintenance and upkeep of the Bank's Premises during the year 2008, 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.

The hostel block at CBS Rajagiriya renamed as Sovereign Residencies was fully refurbished at a cost of Rs.100 million. The management of the Sovereign Residencies has been leased out to BMICH for a period of 10 years who was selected inviting public

tenders in national newspapers. The BMICH is required to invest about Rs.50 million to convert this Residencies to three star level hotel and is expected to commence operation in the first week of February, 2009.

The Premises Department commenced the construction of a new building for Regional Office, Matale in March 2008 at a cost of Rs.45 million. The two-storied office building having a gross floor area of approximately 11,000 square feet including an auditorium with 160 seats is located at Trincomalee Street, Matale. The building is scheduled to be opened on 1st February 2009.

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 work it was decided to repair and refurbish the entire regional office building at a total cost of Rs. 30 million. The work involved with a major structural demolition and construction of a super structure. All the major demolition and construction works has already been completed and internal and finishing works are rapidly in progress. The building is scheduled to be opened on 1st March 2009. In addition Regional Office Manager's Bungalow was also refurbished.

The external colour washing of the CBSL head Office and Chatham Street Clock Tower was completed satisfactorily. The head Office Building had not been colour washed since its first colour washing after the construction of the building in 1999. Estimated cost for the above two works was Rs. 20 million approximately. Cleaning of sun-breakers of extension building were also completed.

The Premises Department set up a state-of-the-art Money Museum within the premises of the Regional Office in Anuradhapura. The project was completed within a period of nine (09) weeks and was declared open on 5th September 2008 to the public.

Emergency landing system for the elevators at CBSL was installed at a cost of Rs.8 million. Construction of Gymnasium was also completed at a cost of Rs.3 million.

The Department continued to maintain the external beautification of all the premises of CBSL.

20. PUBLIC DEBT

Public Debt Department (PDD) continued to carryout its responsibilities relating to issuing and managing public debt on behalf of the government as its agent with improved accountability and transparency. Accordingly, the PDD raised funds required to

finance government needs at lowest possible cost over medium to long run and with a prudent degree of risk, maintained the unblemished debt servicing record by settling government debt servicing obligations on time with 100 per cent accuracy and took every possible measures to broaden and deepen the Government Securities (GS) market. As per the strategic plan of the Central Bank in 2008, the PDD updated the medium term debt management strategy, which formulated in 2007. The debt management strategy addresses the bunching of debt maturities, the fragmentation problem in the Treasury bond programme, the development of long-term yield curve, development of a credible and liquid debt market and recording of all investor transactions of GS transactions in the Central Depository System (CDS). It also recommended a cautious borrowing plan to reach the medium term debt/GDP target, to broaden investor base, to strengthen the existing regulatory and payments and settlements framework and to restructure the primary dealer system.

The maturity structure of the outstanding debt profile indicates that there is a significant bunching of debt maturities towards the shorter end of the maturity profile. In 2008 the PDD was able to ease the bunching problem in the Treasury bills programme and smoothen the maturity structure by increasing the issuance of 364 day Treasury bills and limiting the issuance of 91 day bills. However, it was not possible to issue Treasury bonds with longer maturities due to the high yield rates prevailed for long term maturities in the market. The PDD continued the policy of re-opening the existing Treasury bond series limiting the introduction of new bond series to the market as much as possible to address high fragmentation of the domestic debt market. However, sharp increase of borrowings from domestic sources due to shifting of external foreign borrowings to domestic sources affected the planned reduction of number of bond series in 2008. Despite this issue, the PDD was able to maintain the total number of Treasury bond series at 42 at the end 2008, as in 2007. Considering the importance of the strengthening of the Primary Dealer (PD) system the PDD has taken necessary steps to restructure the PD system in order to diversify their activities and pending necessary legal approval to implement the programme.

In 2008, licensed commercial banks were permitted to purchase international sovereign bonds issued by the government in 2007, at the secondary market with a view to enhance the liquidity of the sovereign bonds. In order to broaden the investor base in the GS market

and to lower the pressure on the interest rates in the domestic market, Treasury bill market was also opened to foreign investors in May 2008 allowing them to invest in Treasury bills up to 10 per cent of outstanding stock.

With the introduction of CBSL Wide Area Network based application to record small value transactions of GS and the introduction of mandatory requirement of recording transaction in the system, the value of transactions took place through Scripless Securities Settlement System (SSSS), and the number of accounts maintained at Central Depository System (CDS) has significantly increased in 2008 compared with the previous year. This measure helped to enhance the safety of small investors in the GS market. In addition, the PDD introduced Personal Computer Based Payment and Securities Settlement System that can be used as an alternative settlement system in an event of prolonged and unrecoverable LankaSettle Application System.

In order to expand the GS market and diversifying the investor base, the PDD conducted an aggressive investor awareness programme through electronic media and, public and educational seminar campaign throughout the year. In addition the PDD released a documentary film on GS in 2008 to educate general public and it was telecasted through various TV channels and at various forums, exhibitions and seminars. In 2008, PDD continued to publish its annual publication on public debt management in Sri Lanka with a view to enhance the transparency in public debt operations and disseminate information on level and management of public debt to the general public, policy makers, academics and players in the GS market. PDD arranged a non-deal road show in selected Middle-East countries to test the investor appetite and expand the investor base for the country. In addition, a team of officers representing the Ministry of Finance, Attorney Generals Dept. and the Central Bank were trained on various products issued under the Sharia principles to tap investors in Middle-East market.

PDD also facilitated two sovereign rating missions with Fitch Ratings and Standards and Poor's in 2008 and a seminar on sovereign ratings was arranged with the assistance of JP Morgan rating advisors to the CBSL staff and MOF officials.

20.1 Developments in 2008

(a) Borrowing Target and Strategy

In terms of the Appropriation Act No.61 of 2007, Parliament approved total gross borrowing limit of the government for 2008, in terms of book value, was

amounted to Rs. 708 billion including Rs. 19 billion provision for contingencies. Of this borrowing limit, Rs. 475 billion was expected to be financed from domestic sources while the balance Rs. 233 billion was expected to mobilize through foreign sources. However, the global financial turmoil, existed during the later part of the year did not permit government to mobilize expected foreign commercial borrowings and it had to be shifted to domestic borrowings. Accordingly, given domestic borrowings increased by Rs.76 billion to Rs. 551 billion and gross foreign borrowings delivered by Rs.97 billion to Rs.136 billion during 2008 while maintaining total borrowings within the original gross borrowing target.

In line with the high inflation experienced since 2007, domestic interest rates were remained high during 2008. Therefore, PDD had to rely more on short term and medium term domestic debt instruments rather than longer-term debt instruments. Thus, Rs. 61.9 billion was raised through Treasury bills and Rs. 406.5 billion was raised through Treasury bonds compared with original target of Rs. 10 billion and Rs. 362 billion respectively. In addition Rs. 36.1 billion (US Dollar 335 million) borrowed through SLDB in 2008 out of the target of Rs. 37.6 billion (US Dollar 360 million). The PDD did not issue any Rupee loan during 2008 continuing the strategy of cutting down non-marketable debt stock from the domestic debt stock.

In 2008 the PDD attempted to ease the monthly bunching pressure in the Treasury bills by limiting issues of 91 day Treasury bills and increasing the issuance of 182 day and 364 day Treasury bills. Accordingly, issue of Treasury bills with 3 month maturities were reduced to 32 per cent of the total Treasury bill issues in 2008 from 67 per cent in 2007, and increased issue of 12 month bills to 41 per cent in 2008, from 14 per cent in 2007. However, this strategy could not be successfully adopted in the Treasury bonds and issue of Treasury bonds with maturities above 3 year were only 29 per cent of total issues due to the high yield rates prevailed for long term maturities in the market.

PDD was able to borrow only Rs. 39 billion from the external foreign commercial sources in 2008 compared to the target of Rs. 67 billion, due to the global financial turmoil. Out of this, Rs.16 billion was raised through a syndicated loan and Rs. 22.9 billion raised by issuing Treasury bills and Treasury bonds to foreign investors. Although, government expected Rs.166 billion for public investment programme through Project/ Programme loans from foreign concessional sources, only Rs.97 billion were realized during the year 2008.

Table II - 13
Issues and Maturity of Domestic Debt in 2008 (a)

Rs. mn.

	Maturity	Issues	Repayments	Net Issues
Treasury bills	91 day	172,696	239,187	-66,491
	182 day	147,654	128,036	19,618
	364 day	156,519	97,427	59,092
	Other	302,707	212,980	89,727
	Total	779,576	677,630	101,946
Treasury bonds	1 year	45,549	39,154	6,395
	2 year	179,192	2,700	176,492
	3 year	123,690	119,457	4,233
	4 year	93,423	9,100	84,323
	5 year	26,072	43,700	-17,628
	6 year	2,550	43,500	-40,950
	10 year	18,261	-	18,261
	Total	488,737	257,611	231,126
Rupee Loans	9/10 year	-	1,500	-1,500
	Total	-	1,500	-1,500
Sri Lanka Dev. Bonds (b)	2 year	36,121	34,474	1,647
	Total	36,121	34,474	1,647
Loans from FCBUs (b) (c)	<= 1 year	8,078	5,400	2,678
	2 years	215	1,663	-1,448
	Total	8,293	7,063	1,230
Grand Total		1,312,727	978,279	334,448

Source: Central Bank of Sri Lanka

(a) Face Value

(b) Excludes the conversion of FCBU loans worth USD 593.1 mn to Sri Lanka Dev. Bonds in July 2008

(c) Includes the payment of USD 50 mn loan taken from NSB in October 2007

(b) Issuance of Debt Instruments

In 2008, the PDD conducted 52 Treasury bill auctions and issued a sum of Rs.779.6 billion (face value terms) Treasury bills in gross terms through auctions and placements. This includes Rs.14.7 billion in gross terms issued to foreign investors. Meanwhile, the PDD raised Rs. 488.8 billion (face value terms) through 76 Treasury bond auctions and through private placements. This includes foreign investments amounted to Rs. 10.5 billion.

There were two Sri Lanka Development Bonds (SLDBs) reissues taken place in June and September 2008. The PDD was able to raise US Dollar 275 million and further US Dollar 60 million by issuing SLDBs with maturity period 2 years. Further, US Dollar 593.1 million loans from Foreign Currency Banking Unit (FCBUs) of Bank of Ceylon were converted to SLDBs with maturity period 2 year (US Dollar 195 million) and 5 year (US Dollar 398 million) in July 2008. In addition, loans amounted to US Dollar 77 million were mobilized from the FCBUs of local banks.

(c) Debt Service Payments

During the year 2008, the PDD serviced both foreign and domestic loans amounting to Rs. 592.8 billion. Out of the total debt serviced, Rs. 212.5 billion was for interest while the principle repayments were Rs. 380.3 billion. Total domestic loan serviced amounted to Rs. 440.9 billion and the foreign debt serviced amounted to Rs.151.9 billion (pre-mature withdrawals of foreign investments in Treasury bonds were considered as repayments to foreigners). In addition, maturing Treasury bills amounting to Rs. 678 billion were reissued during the year.

(d) Yield Rates and Secondary Market Performance

The gradually rising trend in the yield rates of GS which was experienced over the recent past, turn round since the beginning of 2008. High demand for GS from foreign investors with the opening up of Treasury bill market to foreigners in May, 2008, lower inflationary expectations over the second half of the year, liquidity surplus remained in the market (except latter part of the year) could cited as major contributory factors to arrest the increasing trend in the yield rates in the domestic market.

Treasury bill yield rates for 91, 182 and 364 day maturities declined by 520 bps, 255 bps and 215 bps, respectively, in the secondary market between January to September 2008, while yield rates for Treasury bonds with maturities of 2-5 years declined by 140-250 bps, during the same period. Both primary and secondary market yield curves showed a gradual downward shift, reflecting the decreasing trend in the interest rates during January to September 2008. This is mainly due to the high level of participation by foreign investors in the market. However, the yield rates in both primary and secondary markets started to increase from September to December as foreign investors started to unload their holdings of GS owing to aggravation of the global financial turmoil, creating an excess supply in the market. Deficit liquidity conditions prevailed in the market since September 2008 also added pressure on the interest rates in the market. However, by end of the year, the rising trend of the yield rates eased to some extent and the yield rates of the secondary market stabilized, indicating the positive market response to the decreasing inflation and inflationary expectations.

(e) Scripless Securities Settlement System (SSSS) and the Central Depository System (CDS) – LankaSecure

During 2008, PDD was able to maintain the LankaSecure operations smoothly with its

participants, including 22 Licensed Commercial Banks (LCBs), 8 non-bank primary dealers, Employees' Provident Fund and Central Depository Systems (Pvt) Ltd of the Colombo Stock Exchange (CDS (Pvt) Ltd). The number of transactions took place through SSSS has significantly increased by 85 per cent in 2008 compared with 60 per cent increase in 2007. The value of those transactions increased by 45 per cent, which is Rs. 26,038 billion. The number of accounts maintained at Central Depository System (CDS) has further increased to 56,041 in 2008 from 41,953 in 2007 as a result of the introduction of CBSL Wide Area Network based application to record small value repossession transactions free of charge in 2007 and expansion of the investor base due to aggressive investor awareness campaigns. LankaSecure continued to dispatch its statements to the investors to increase their confidence level. Lanka SecureNet facility is another free of charge service provided by LankaSecure, providing online access to the investor's CDS account to view their GS held at CDS.

PDD was instrumental in issuing a new direction with an objective of moving towards a comprehensive Disaster Recovery Plan. The introduction of Personal Computer Based Payment and Securities Settlement System was made effective from 18 August 2008, that can be used as an alternative settlement system in an event of prolonged, unrecoverable LankaSettle application system.

(f) **Primary Dealer Supervision**

With a view to maintaining the Financial System Stability the PDD continued to supervise the PDs through regular off-site surveillance, on-site examinations and spot examinations during 2008. Seven regular on-site examinations and one spot examination were carried out during the year which focused on an assessment of the PDs' exposure to risks, i.e. market risk, liquidity risk, operational risk and other risks, the management of those risks and the adequacy of resources, i.e., earnings, capital and management, to mitigate those risks at prudent levels. Meanwhile, regular CEOs meetings of PDs were conducted throughout the year to discuss matters and to get the views of PDs to maintain the PD industry in a proper manner.

The Master Repo Agreement (MRA), which can be commonly used by the PDs and Licensed Commercial Banks (LCBs) in their repo transactions has been finalised by the PDD in collaboration with the Association of Primary Dealers (APD) and the Sri Lanka Banks' Association (Guarantee) Ltd.

Accordingly, all PDs and LCBs are expected to use this common MRA in their repo transactions with effect from 1st January 2009.

(g) **Government Securities Market Development**

In order to develop GS market expanding the investor base, PDD conducted an aggressive investor awareness programme through electronic and print media coupled with a public and educational seminar programme. During the year the PDD organized 14 public investor awareness programmes, 24 students and teachers awareness seminars, and 30 radio programmes jointly with Sri Lanka Broadcasting Corporation. Meanwhile, PDD released a documentary film on GS in 2008 to educate general public and telecasted the film 28 times on various TV channels and at various forums, exhibitions and seminars. In addition with a view to educate the general public on GS the PDD participated in 8 TV discussions that telecasted locally as well as overseas.

21. REGIONAL DEVELOPMENT

During the year under review, the Regional Development Department (RDD) continued to engage in activities aimed at promoting regional development initiatives through coordinating and encouraging credit delivery to strategic sectors. This was achieved primarily through a series of refinance, interest subsidy and credit supplementation schemes. The improved security situation that prevailed in the newly liberated Eastern province in 2008 provided an opportunity for RDD to actively engage in enhancing the flow of funds to that province. In the area of poverty alleviation, RDD continued with the implementation of the Poverty Alleviation Micro Finance Project Revolving Fund (PAMP-RF) scheme and a special effort was made to target those in poverty in the Eastern Province. Initial work was also completed on the Poverty Alleviation Micro Finance Project phase II (PAMP-II) which will mainly cover conflict affected districts. In April 2008, the RDD commenced implementing the Agro-Livestock Development Loan (ALDL) scheme which was announced in the Budget for 2008. In line with the sharp increase in agriculture growth during the year, there was a significant increase in demand for credit under most agriculture-allied credit programmes. An impact assessment survey of Tsunami rehabilitation loan schemes was undertaken during the third quarter of the year while preliminary work in connection with a comprehensive impact assessment survey of PAMP was also completed during the year.

In 2008, the RDD implemented/coordinated the loan schemes given in Table 1 below in respect of which either refinance was provided or interest subsidy was paid to Participating Financial Institutions (PFIs).

21.1 Development of the Eastern Province

RDD made use of the opportunity arising from the improved security situation in the Eastern Province in 2008 to concentrate on activities aimed at accelerating the development in that province. As progress of Tsunami rehabilitation activities in the Eastern Province had been retarded earlier due to hostilities, the Susahana Phase II (Revolving Fund) scheme was extended to cover all Tsunami damaged Micro Small and Medium Enterprises (MSME) in that province. Under this scheme, funds were made available at a concessionary interest rate of 6 per cent. A sum of Rs. 500 million has been allotted for this purpose out of recoveries of the original Susahana scheme. Further, credit for Tsunami rehabilitation is also available under the EIB- (Contract B) loan scheme. In addition to holding two press conferences on banking facilities available for Eastern Province development, RDD participated in 39 awareness programmes for bank staff, public officials NGOs and the general public to educate them on special credit schemes available, for agriculture and other development activities, at concessionary interest rates. RDD also targeted poor beneficiaries in the province under the PAMP-RF with the help of identified Participating Agencies (PAs) and PFIs. The number of beneficiaries enrolled in the scheme in the Eastern Province under PAMP-RF stood at 4,732 as at end 2008. Of these, 1,517 beneficiaries were granted loans to a total value of Rs. 52.1mn. to commence income generating activities. In total, loans to the value of Rs. 432.7 mn. were disbursed under the NCRCS, PAMP-RF, EIB, Susahana II and Krushi Navodaya Schemes in the Eastern Province. Further, under PAMP II, which will target 14 districts comprising those in the Northern and Eastern Provinces and districts bordering these two provinces, further funds for poverty alleviation activities will be available to the Eastern Province.

21.2 Agriculture and Animal Husbandry Sector

The introduction of the Agro-Livestock Development Loan (ALDL) scheme in April 2008, was a major step taken during the year with regard to financing the agriculture and animal husbandry sector. This scheme which was included in the Budget 2008 on the recommendation of CBSL was mainly aimed at promoting liquid milk production in the country. In addition to dairy farmers, loans are also available at

a concessionary rate for milk processing and crop processing industrial units which have entered into Forward Sales Contracts (FSCs) to purchase milk output/crop output of 1,000-10,000 dairy farmers/cultivators (Please see Table 1 for details on interest rates, scales of finance and eligible activities). A salient feature of this loan scheme was that the release of funds was made conditional on adopting good animal husbandry practices. This loan scheme finances along the value chain of the milk industry by providing credit to dairy farmers as well as liquid milk processors. Altogether 3,549 loans to a total value of Rs. 880.8 mn. were registered¹ under the ALDL scheme in RDD during 2008.

With the sharp growth in the agriculture sector experienced during 2008, loan disbursement for crop cultivation under the NCRCS scheme expanded significantly. Altogether, loans to a total value of Rs 1,571.6 mn. were granted in Maha 2007/08 for crop cultivation. This represents a 62 percent increase in the value of loans granted compared to Maha 2006/07. In Yala 2008, the value of loans granted was Rs. 1,178.6mn. which represents an increase of 38.4 percent when compared with Yala 2007. Meanwhile, the high growth experienced in the agriculture sector and the volatility in commodity prices in 2008 served as an impetus to increase the number of FSCs signed, as both producers and product purchasers sought to limit their price risk exposure by using the FSC mechanism. The value of loans given for purchasing of produce under FSCs increased by 104 percent to Rs 3,918.2 mn. in Maha 2007/08. The corresponding figure for Yala 2008 was Rs. 3,866.0 mn. representing an increase of 52.0 percent over the previous Yala. Meanwhile, in the Krushi Navodaya Scheme under which PFIs granting medium and long term credit to micro and small enterprises for agriculture related activities at concessionary interest rates are eligible for interest subsidy payments, loans to the value of Rs. 552.3 mn. were disbursed in the first half of 2008. It is noteworthy that several banks were able to disburse a fair quantum of loans in the Northern Province as well under this scheme. In July 2008, in line with the high interest rate structure prevailing during the year, the on-lending interest rate under the NCRCS and Krushi Navodaya schemes were revised upward to 12 percent with the Government making an interest subsidy payment of 8 percent and thereby making the effective rate of interest 20 per cent for PFIs. Credit continued to be disbursed under the SPCDP-RF and TDP-RF schemes during the year with Rs. 117.2 mn. and Rs 262.8 mn. respectively being disbursed by these two schemes respectively. The closing months of 2008 saw a sharp drop in tea

Table II - 14
FEATURES OF REGIONAL DEVELOPMENT LENDING PROGRAMMES
IMPLEMENTED BY THE REGIONAL DEVELOPMENT DEPARTMENT

Project and Implementation Period	Source of Funds	Broad Mission	Fund Allocation	Annual Interest Rate to Borrowers	Recovery Rate where applicable
1 Agricultural and Annual Husbandry					
1.1 Second Perennial Crops Development Project (SPCDP-RF) 2006-2014		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) - (TDP-RF)- 2006-2018		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)		Provision of the working capital requirement of small farmers <ul style="list-style-type: none"> • Short-term production loans. • Production of seeds and plant material. • Purchase of agricultural commodities under Forward Sales Contracts. 	Loans granted by PFIs using their own funds	8% until July 2008 and 12% thereafter	Around 90%
1.4 Agro-Livestock Development Project Loan Scheme (ALDL) (2008-2010)		In dairy farming provision of capital for <ul style="list-style-type: none"> • Construction of cattle sheds. • Purchase of Cows. • Purchase of concentration feed, veterinary services & drugs etc. • Cultivation of animal fodder. • Construction of bio-gas tanks. • Any other requirements recommended by Veterinary surgeons. In liquid milk processing industries and Agro-based Industries provision of funds for <ul style="list-style-type: none"> • Construction of industrial buildings/ Modernization. • Purchase of modern machinery and equipment. • Storage, cold rooms and transport services. • Other required services, equipment for maintenance of standards. 	Loans granted by PFIs using their own funds. Total fund delivery expected to be Rs.5,000 mn.	For small dairy projects 12% For milk and crop processing 14%	
1.5 Krushi Navodaya Scheme(March 2007- end February 2010)	PFIs 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 PFIs using their own funds- Total fund delivery during operational period expected to be Rs.3,000 mn.	8% until July 2008 and 12% thereafter	Approximately 90%

Project and Implementation Period	Source of Funds	Broad Mission	Fund Allocation	Annual Interest Rate to Borrowers	Recovery Rate where applicable
2 Small and Medium Enterprises Sector					
2.1 Matale Regional Economic Advancement Project (Revolving Fund) - (MREAP-RF) (2007-2009)	IFAD	Raising the income of rural and farm families by providing funds for small and medium scale enterprises in the District.	Rs.77 mn.	10%	87%
2.2 Sabaragamuwa Province Integrated Rural Development Project (Revolving Fund) - (SPIRDP-RF) (2007-2010)	GOSL	Upliftment of the living conditions of the people in the project area by promoting income-generating activities.	Rs.100 mn.	10%	93%
2.3 Post-Tsunami Line of Credit – EIB Contract B Loan Scheme (2006-2014)	EIB	To assist the affected small and medium scale enterprises for resumption of business in the Tsunami affected districts.	EURO 20 mn.	9%	Within the Grace Period
2.40 Sushana Loan Scheme(Phase II)	CBSL	To assist micro, small and medium scale enterprises affected by the tsunami to resume business	Rs.500 mn.	6%	Within the Grace Period
2.5 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.	EURO 10 mn.	9%	Within the Grace Period
3. Micro Finance Sector					
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.	SLR 200 mn.	10%	Within the Grace Period
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%	Disbursement yet to commence
3.3 Small Farmers & Landless Credit Project Revolving Fund	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.	SLR 512.7 mn.	16% - 20%	Over 90%
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. Organizing low-income groups to link with the formal banking system.	SLR 1,250 mn.	16%	Over 90%

prices and the need arose for the Sri Lanka Tea Board (SLTB) to intervene to purchase tea in order to stabilize prices. RDD accordingly arranged a refinance facility for Bank of Ceylon and People's Bank in respect of special accommodation granted to SLTB at a concessionary rate of 12 percent for purchasing of tea with a view to stabilizing tea prices. Under this scheme, refinance to the value of Rs. 231.4 mn. was released in 2008.

21.3 Promoting SME financing

Loan disbursement under the Construction Sector Development Project (CSDP) progressed satisfactorily during the year with refinance to the value of Rs. 632.2 mn. being released to PFIs in 2008. Under the EIB Post Tsunami (Contract B) Line of Credit, refinance to a total value of Rs. 581.6 mn. was released during the year. The Sabaragamuwa Integrated Rural Development Project Revolving Fund (SIRDPRF) scheme and the Matale Regional Economic Advancement Programme Revolving Fund Scheme (MREAP-RF) also continued to be operational in the relevant districts in 2008. Under SPIRDP-RF, refinance was released in respect of loans amounting to a total value of Rs. 42.3 mn. during the year while under MREAP-RF, refinance was released in respect of loans amounting to a total value of Rs 54.9 mn. Field work in respect of a survey to determine the impact of three of the Tsunami rehabilitation loan schemes, Susahana, SBRP and Jeewanashakthi, was completed during the year.

21.4 Poverty Alleviation

The PAMP-RF programme continued to be operational throughout the country in 2008. The number of beneficiaries enrolled under this programme during the year was 41,827. Out of these, 15,200 beneficiaries had been issued loans to the value of Rs. 513.9 mn. to commence income generating activities. Meanwhile, the Small Farmer and Landless Credit Project (SFLCP) also progressed in 2008 with loans to the value of Rs 143.9 mn. being disbursed to 5,610 beneficiaries. All preliminary work with regard to PAMP-II was completed during 2008. This scheme which is funded by the Japan International Cooperation Agency (JICA) is expected to be operational from early 2009. With the impending liberation of the North, PAMP II is expected to be fully operational in the Northern Province as well in 2009.

In order to improve poverty alleviation programmes and design new programmes it is very important to evaluate on-going programmes as well as programmes which have been completed, to

determine their impact on targeted beneficiaries and the community at large. With this objective in view, a comprehensive impact assessment survey was designed to evaluate the original PAMP and all preliminary work including design of questionnaire and table formats, selection of sample and extraction of baseline information was completed in 2008.

21.5 Credit Supplementation

The RDD continued to be involved in routine activities relating to operations of credit supplementation schemes such as collection of annual premia, processing of claim applications, payment or rejection of claims and following up on post claim recovery in respect of the 12 credit supplementation schemes operated by RDD. The total premia collected in 2008 under these 12 schemes was Rs. 66.4 mn. while payment of credit guarantee claims amounted to Rs. 30.6 mn. during the year. Issue of new credit guarantee cover was limited to only the NCRCS scheme in 2008 as credit disbursement in respect of the other schemes had terminated. At the request of the Government, the RDD introduced a new Credit Guarantee Scheme covering loans to small and medium scale enterprises in the Gem and Jewellery Sector provided by banks under the Production Unit Modernization Scheme. The Department was also involved in finalizing details of the proposed new credit guarantee scheme for the Micro Small and Medium Enterprise (MSME) Sector which is designed to encourage project based lending rather than collateral based lending to MSMEs.

21.6 Regional Offices

As in the recent past, the three Regional Offices (ROs) in Anuradhapura, Matara and Matale continued their operations for enhancement of the access to finance in their operational districts/areas and provision of logistical support to various Departments of the Central Bank. The main activities with regard to enhancement of access to finance included organization of credit awareness programmes for beneficiaries and state extension services, coordination/promotion of support services for implementation of concessionary development credit schemes formulated by the Central Bank through PFIs and promotion of FSCs on agricultural commodities between farmers and buyers. During the year, 357 awareness meetings/programmes facilitating nearly 20,000 beneficiaries were arranged by ROs. Anuradhapura and Matale ROs were involved in activities relating to the signing of nearly 28,000 FSCs with a total income/turnover of Rs. 4,570 mn. for agricultural produce, mainly, Maize,

Paddy, Soya, B'onions, Ginger and fresh milk and for provision of credit facilities from banks to farmers based on the security of FSCs signed. The provision of logistic support to the Central Bank included arrangement of seminars and awareness programmes, sales of commemorative coins and Central Bank publications, conduct of coin collection programmes, attending to member-inquiries on Employees' Provident Fund, collection and supply of various economic data, conduct of field investigations and field level inspections on various matters. In September 2008 a currency museum was opened in the Anuradhapura RO in which, among other exhibits, currency belonging to the Anuradhapura and Polonnaruwa periods are on view.

In view of the emerging need for active participation of the Central Bank for regional development activities to facilitate increased access to finance and the Central Bank's regional presence in coordination of state extension services, a policy decision was taken to expand the operations of ROs in 2009. Accordingly, arrangements were finalized to establish a new Department in 2009 with the functions of formulation of policies for operations of ROs and monitoring of the performance of ROs. Further, a proposal for establishment of new ROs to facilitate fast development in the liberated North and East provinces is also under consideration.

22. SECRETARIAT

In 2008, 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 48 tenders during the year and procured capital goods and services and non-capital items amounting to Rs.79.7 million and Rs.55.9 million respectively, by assuring and maintaining quality, timeliness and competitive prices. The concept of procurement planning was put in place to monitor the procurement management process of the Bank in order to streamline the timely supply of goods and services to the user departments. As a result, Secretariat Department was able to complete the supply of 87 per cent of total procurement requirement of the Bank successfully during the year. In addition, 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, the updating of the Central Bank Manual was completed and it will be released in 2009. 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 1,956 pensioners have been enrolled under these schemes and the automation of existing data base for these schemes was in progress with the development of a software programme for the release of Provident Fund.

In 2008, the department has coordinated and organized various religious and commemorative events and annual ceremonies such as Long Service Award Ceremony and Independence Day Ceremony.

23. SECURITY SERVICES

The Security Services Department (SSD) continued to strengthen the security in the CBSL with a view to protecting employees, buildings and properties, visitors and the currency consignment in transit. A number of security strengthening measures were taken in 2008. Active contribution of SSD was provided for testing of Business Continuity Plan for the critical operations of the CBSL in August 2008. Eight fire drills and five Awareness Programmes for the employees on handling emergency situations including fire fighting and first aid were conducted. The existing CCTV cameras were upgraded with Night Vision Capability Cameras in order to support the security forces Air Defence Plan. Preliminary arrangements were made to replace existing outdated baggage and cargo scanners with new ones and new outsourcing of certain security supported services. A new Fire Alarm System was installed at Centre for Banking Studies (CBS), Rajagiriya. A special physical fitness programme was introduced for all the security personnel of SSD with a view to increase their physical efficiency. Foreign training on Advanced Security Management, Fire Fighting, Security Supervising and Control Room Management was given for eight security personnel while ten personnel were given local training opportunities in related fields.

24. STATISTICS AND FIELD SURVEYS

The Statistics Department continued its operations on collection, compilation, analysis and dissemination of data on provincial national accounts, prices, wages, labour force and employment, and other socio economic sectors in 2008. The Department released socio-economic data and information regularly to the general public through

the publication of Weekly and Monthly Selected Economic Indicators. The Department continued to issue regular monthly press release on the behavior of consumer prices and inflation.

In addition, the department actively provided resource persons for the public awareness programme of the CBSL for training programmes, seminars and media discussions during the reference year. Many officers 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.

24.1 Statistical Surveys

The monthly Inflation Expectations Survey which was initiated in 2006 was continued during 2008 to assess the expectations of consumers, investors and business community on future inflation. The results of these surveys were submitted to the Monetary Policy Committee (MPC) and the Monetary Policy Consultative Committee (MPCC) at their monthly meetings to assist the monetary policy formulation.

24.2 Prosperity Index for Sri Lanka

Prosperity Index for Sri Lanka to measure and compare the prosperity of Sri Lanka and its provinces was launched in 2008. The index was the culmination of a two-year research project and feed back received from professionals through discussions, seminars and awareness programmes.

24.3 National and Regional Income Accounts

The process of monitoring the developments in the real sector of the economy and forecasting national income continued during 2008. This included collection of primary and secondary data, analysis of developments and forecasting future trends in production, consumption, savings and investments in the country.

The department completed compiling Gross Domestic Product at Provincial Level (PGDP) for 2007 by disaggregating the Gross Domestic Product (GDP) compiled by the DCS. The PGDP statistics are estimated at current market prices and these statistics reveal the provincial contribution to the national GDP. The information on PGDP is useful to the provincial authorities as well as the national planners of the central government to introduce and implement appropriate strategies to alleviate income disparities among provinces.

24.4 Country Wide Data Collection System (CWDCS)

The Country Wide Data Collection System (CWDCS) which commenced in 1978, completed its thirty years of operation in 2008. The data collection was accomplished through an island-wide network of government school teachers. They function as statistical investigators for 101 data collection centres operated in the island including 18 data collection centres in the Northern and Eastern provinces. Information on retail prices of consumer goods, producer prices of agricultural commodities and daily wage rates pertaining to the informal sector was collected under this programme. Daily wage information was collected in the areas of paddy, tea, rubber and coconut cultivation, small-scale construction and services. Collection of wholesale and retail prices of major food items from the Pettah market and other centres such as the Marandagahamula rice market and the Dambulla Economic Centre was carried out by non-teacher investigators appointed by the Department. The collection and dissemination of market information on the newly established Narahenpita Special Economic Centre was also commenced by the Department soon after its opening in December, 2008. The quality and timeliness of data collection was further strengthened through off-site supervision and continuous monitoring of the prices forwarded by the investigators and through regular on-site supervision. Some data collection forms were amended taking into account the current developments in the markets such as disappearance of some products and trade names and changes in unit sizes.

Four regional seminars were conducted in Colombo, Matara, Anuradhapura and Kandy in 2008 to provide refresher training for the data collectors in order to improve the accuracy, quality, efficiency and timeliness of their data collection and to obtain their input on the reasons for differences in price developments across centres and regions. At these programmes, special sessions were also conducted to educate them on contemporary developments in the economy in the areas such as inflation and newly introduced Colombo Consumers' Price Index, Sri Lanka Prosperity Index and Government Securities market in Sri Lanka with a view to transfer knowledge to school children and other members of the society. The effectiveness of such programmes was reflected in the improved awareness and the enthusiasm shown by the teacher investigators.

24.5 Prices, Wages and Employment

The Department continued to analyse the movements in consumer prices and inflation using the Colombo Consumers' Price Index (CCPI), (2002 = 100) introduced by the Department of Census and Statistics (DCS) in November, 2007.

The Department continued to compile the provincial Consumer Price Indices (CPIs) and the All Island Consumer Price Index, based on the latest Consumer Finances and Socio Economic Survey (CFS) of 2003/2004, with 2003-2005 as the base period.

The Department also compiled the Wholesale Price Index (WPI), to analyse the movements in producer and wholesale prices at the primary market level, and Informal Sector Wage Rates (ISWR) for Sri Lanka, based on the CWDCS wage data.

The Department conducted Annual and Quarterly Public Sector Employment Surveys (APSES and QPSES). Surveys covered all Central Government and Public Sector institutions with over 1,000 employees each as reported in APSES of 2007, excluding those under Provincial Councils. The Department also analysed the information collected on labour force and labour market covering the areas of foreign employment, labour relations and labour market reforms during 2008.

24.6 Dissemination of Statistics

The Department released two annual publications "Economic and Social Statistics of Sri Lanka 2008" – Volume XXIX in March 2008 and "Sri Lanka Socio Economic Data 2008" – Volume XXXI in June 2008. In addition, the statistical tables in the pocket diary 2008 of the Bank were also updated.

The Department commenced a new project to establish a data library on economic and social statistics in 2008.

25. SUPERVISION OF NON-BANK FINANCIAL INSTITUTIONS

The Department of Supervision of Non-Bank Financial Institutions (SNBFI Dept.) continued its function of regulating and supervising 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 2008, one specialized leasing company (SLC) and one new public company were registered under the FCA increasing the total number

of RFCs from 32 to 34. Three public companies and one Licensed Specialized Bank (LSB) were registered under the FLA. With the registration of four new companies under the FLA, the total number of Registered Finance Leasing Establishments (RFLEs) increased to 78 at the end of the year.

25.1 Registered Finance Companies

SNBFI Dept. carried out its regulatory and supervisory functions through off-site surveillance and on-site examinations. Off-site surveillance was carried out on a monthly basis for all the companies, while on-site examinations were conducted on a pre-planned schedule, once in two years. The companies that were not subject to on-site examinations during the year were subject to spot examinations in specific areas of operations.

(a) Off-site Surveillance

Off-site surveillance of RFCs and SLCs was carried out by analyzing the information received through periodic returns submitted by the companies, to ascertain the financial condition of RFCs and SLCs and their compliance with the Directions issued and Rules made by the Monetary Board under the provisions of the respective Acts.

(b) On-site and Spot Examinations

On-site examinations were carried out to assess the liquidity, asset quality, capital adequacy, management efficiency, earnings, profitability, systems and controls and the status of corporate governance of RFCs. During 2008, SNBFI Dept. conducted 11 on-site examinations of RFCs under its examination plan. In addition, 17 RFCs that were not subject to comprehensive on-site examinations during the year were examined on a spot basis, selecting critical areas such as liquidity, credit administration, assets portfolio, capital adequacy and systems and controls etc.

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

(c) **Issue of Directions**

During the year, the following four directions were issued.

- (i) **The Finance Companies (Interest) Direction, No. 1 of 2008** - This Direction which revoked Finance Companies (Interest) Direction, No. 2 of 2005, stipulates limits on the maximum annual rate of interest which may be paid by any finance company on a time deposit, a savings deposit, a bond or other instrument issued at a discount.
- (ii) **The Finance Companies (Interest) Direction, No. 2 of 2008** - This Direction was an amended form of Finance Companies (Interest) Direction, No. 1 of 2008, which simultaneously revoked that Direction.
- (iii) **Finance Companies (Corporate Governance) Direction, No. 3 of 2008** - Directions on corporate governance, which were developed on the basis of certain principles of corporate governance issued to licensed banks, were issued to Registered Finance Companies to be applicable from 1 January 2009. The main aspects covered are the responsibilities of the board of directors, composition of the board of directors, criteria to assess the fitness and propriety of directors, management functions delegated by the board, separation of duties of the Chairman and the Chief Executive Officer, board appointed committees and disclosure of financial statements. A number of transitional provisions on several key aspects of the Direction were provided to facilitate a smooth transition to the new requirements. The main purpose of the direction is to make boards of directors more responsible and accountable for affairs of the finance companies to promote a healthy and robust risk management framework for finance companies in order to maintain the overall soundness of finance companies.
- (iv) **Finance Companies (Corporate Governance - Amendment) Direction, No. 4 of 2008** - This Direction was issued to make some changes to the transitional provisions in the Finance Companies (Corporate Governance) Direction No. 3 of 2008.

25.2 Registered Finance Leasing Establishments

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

During the year under review, three public companies and one LSB were registered under

the provisions of the FLA. Accordingly, at the end of 2008, the total number of RFLEs stood at 78, comprising 14 LCBs, 9 LSBs, 33 RFCs and 22 SLCs.

(b) **Monitoring of SLCs**

SNBFI Dept. continued its off-site surveillance of SLCs on a monthly basis during the year 2008 (other RFLEs, i.e., LCBs, LSBs and RFCs were regulated and supervised under separate statutes). In addition, six on-site examinations and 12 spot-examinations of SLCs were conducted by the Department during the year. On-site examinations were conducted to appraise the financial performance, the risks that a particular SLC was 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. Those 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 of such action.

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 those companies, four companies were wound up by end 2008. The process of liquidation continued in the case of five companies. The reports recommending the course of action that can be taken in respect of the failed finance companies which had been forwarded to the relevant authorities are still under review. The Presidential Commission of Inquiry to Investigate into Matters Relating to Failed Finance Companies handed over its final report to H E the President on 15 December 2008.

25.4 Unauthorised Conduct of Finance Business

During the year 2008, the Department continued its investigations of institutions alleged to engage in finance business without authority. In September, the Monetary Board, on consideration of reports submitted by the Department under Section 1 of the FCA, determined that seven companies were carrying on finance business without authority and directed the Department to take action in terms of the provisions of the Act. At end December 2008, the Department had received complaints regarding 56 companies. Legal action had been instituted against 14 companies for conducting finance business contravening the provisions of the FCA or for non-

compliance with Directions issued by the Monetary Board. In order to strengthen the provisions relating to examination of unauthorised deposit taking institutions, necessary amendments have been proposed to the FCA.

25.5 Public Awareness Programmes

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

(a) Publications in newspapers:

Monthly press notices with an explanatory note providing the definition of deposits, categories of institutions/organisations authorised to accept deposits under different laws and a list of institutions authorized by the Central Bank to accept deposits were published. These notices were published jointly with the Bank Supervision Department. In addition, 19 press notices relating particularly to unauthorised financial institutions were published during the second half of the year.

Institutions registered with the Central Bank in accordance with the law as at 31. 12. 2008	
Registered Finance Companies <ol style="list-style-type: none"> 1. Abans Financial Services Ltd. 2. Alliance Finance Company PLC. 3. AMW Capital Leasing Ltd. 4. Arpico Finance Company PLC. 5. Asia Assets Finance Ltd. 6. Asian Finance Ltd. 7. Associated Motor Finance Company Ltd. 8. Bartleet Finance Ltd. 9. Bimputh Lanka investments Ltd. 10. Capital Reach Leasing Ltd. 11. Central Finance Company PLC. 12. Central Investments & Finance Ltd. 13. Ceylinco Investment & Realty Ltd. 14. Chilaw Finance Ltd. 15. Commercial Credit Ltd. 16. Edirisinghe Trust Investments Ltd. 17. Industrial Finance Ltd. 18. Lanka ORIX Finance Company Ltd. 19. LB Finance PLC. 20. Mercantile Investments Ltd. 21. Merchant Credit of Sri Lanka Ltd. 22. Nanda Investments Ltd. 23. Nextfinance Ltd. 24. Senkadagala Finance Company Ltd. 25. Seylan Merchant Leasing PLC. 26. Silverreen Finance Company Ltd. 27. Singer Finance (Lanka) Ltd. 28. Sinhaputhra Finance Ltd. 29. Swarnamahal Financial Services Ltd. 30. The Finance & Guarantee Company Ltd. 31. The Finance Company PLC. 32. The Multi Finance Company Ltd. 33. Trade Finance & Investments Ltd. 34. Valibel Finance Ltd. 	Registered Finance Leasing Establishments <ol style="list-style-type: none"> 1. Asia Commerce Ltd. 2. Assetline Leasing Company Ltd. 3. Capital Reach Credit Ltd. 4. Ceylease Financial Services Ltd. 5. Ceylinco Development Bank Ltd. 6. Ceylinco Finance PLC. 7. Ceylinco Leasing Corporation Ltd. 8. Commercial Leasing Company PLC. 9. Co-operative Leasing Company Ltd. 10. Indra Finance Ltd. 11. Isuru Finance Company Ltd. 12. Kalutota Investment & Leasing Ltd. 13. Koshiba Leasing Company Ltd. 14. Lanka ORIX Leasing Company PLC. 15. Lisvin Investments Ltd. 16. LOLC Micro Credit Ltd. 17. Merchant Bank of Sri Lanka PLC. 18. Orient Financial Services Corporation Ltd. 19. People's Leasing Company Ltd. 20. People's Merchant Bank PLC. 21. Sampath Leasing & Factoring Ltd. 22. Seylan Merchant Bank PLC.

- (b) Officers of the department participated in four awareness programmes to educate the public on unauthorised conduct of finance business.
- (c) A leaflet titled “Mobilisation of Funds from the Public by Unauthorised Persons & Institutions” was published and distributed among the public through RDBs and RFCs.

25.6 Regulation of Micro Financing Institutions

A large number of micro finance institutions (MFIs) are engaged in micro financing activities throughout the country. These institutions are not regulated or monitored through a specific regulatory and supervisory authority or arrangement. In view of the diversity and complexity of the micro finance sector and the existing laws, it has been decided that certain regulatory requirements should be imposed on these institutions. Hence, a regulatory and supervisory regime is being formulated for this sector.

26. WELFARE

During the year under review, the Welfare Department enhanced welfare facilities provided to bank employees, pensioners and dependents while improving the quality of services. The facilities provided by the Welfare Department included medical benefits, housing and vehicle loans, in-house medical centre, restaurant facilities, concessionary loan schemes and other ancillary services.

During the year 2008, the medical benefit facilities provided under the Central Bank Medical Benefit Scheme (MBS) were substantially expanded with an increase in employee's entitlement for medical

benefits and by introducing new categories such as a reimbursement facility for diabetes for employees and pensioners. Meanwhile, the Department enhanced housing and vehicle loan facilities considerably considering the inadequacy of existing provisions in view of the increased cost of construction, land prices and motor vehicles. The new scheme is to be implemented from 2009. Housing loan facilities were further extended by allowing employees who will be retired from the bank service to be benefitted by obtaining their housing loan installments until laps of six months from the date of retirement. Further, to enhance the efficiency of the housing loan granting system pre arrangements were made to automate the system from 2009. The department managed to recover nearly Rs. 9 mn. from housing loan defaulters who have not paid their loan balances for a long period. Meanwhile the department catered to the requirement of loan facilities of the staff in a diligent manner by releasing loans within a very short period of time. The number of housing loans approved during the year was 90 while the number of PF loans granted including SBS loans, computer loans, vehicle loans etc. were 1073.

Self service system in the restaurants helped to have a better service and a better choice to the CBSL employees. Despite the increase in number to be served an efficient catering service was provided with available staff.

A series of lectures on various topics such as health and general topics were conducted by the department for the benefit of the staff in 2008. Also useful health tips were circulated by using electronic media.