

PART II

PART II

ACCOUNTS AND OPERATIONS OF THE CENTRAL BANK OF SRI LANKA

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BOX II - 1**MODERNISATION OF THE CENTRAL BANK OF SRI LANKA****Modernisation Programme**

The modernisation project of the Central Bank of Sri Lanka (CBSL) completed its fourth year in 2003. The progress achieved by the project during the past three years has been reported in the previous Annual Reports of the Bank (see Part II-(Page II)-2000, Part II-(Box II-1)-2001 and Part II-(Box II-1)-2002). The modernisation project aims at building a central bank which is in line with the modern trends in central banking and which is capable of successfully meeting the new challenges faced by a central bank.

A summary of the activities completed during 2000 - 2002 is as follows:

- Redefining CBSL's objectives into two new core objectives, *viz.*, (a) economic and price stability; and (b) financial system stability, with a view to encouraging and promoting the development of productive resources of Sri Lanka. This was effected through an amendment to the Monetary Law Act in December 2002. In terms of this amendment, the CBSL has been freed of pursuing multiple objectives, which are usually in conflict with each other. Hence, the Bank can now vigorously and consistently pursue its core objectives.
- Devolution of non-core functions
 - The Sri Lanka Automated Clearing House was divested by the CBSL in April 2002 to LankaClear (Pvt) Ltd., with the aim of improving the efficiency of the cheque clearing and electronic funds transfer system through new management, technology and cost efficient operations.
 - Outsourcing: The CBSL outsourced many of its non-core functions, particularly in the area of services, thereby enabling the Bank to use its resources exclusively for attaining the core objectives.
- Action was initiated to amalgamate the EPF and ETF and to divest shares held by the CBSL in the Regional Development Banks (RDBs).
- Organisational Changes
 - A new organisation structure was established, categorising departments under the primary objectives or by functional groups, i.e., price stability, financial system stability, agency and business functions and corporate services.
 - Certain departments were amalgamated, re-designated and reconstituted to suit the new needs of the Bank.

• Human Resource and Training

– With the aim of introducing a new culture and enhancing professionalism amongst the staff, a set of new human resource policies was adopted. For this purpose, a Human Resource Manager was recruited in April 2002.

– The Management Development Centre was established to continuously train senior officials of banks and public sector institutions, with the aim of enhancing their knowledge through education, awareness and critical analysis.

– A Voluntary Retirement Scheme was offered to the staff and 690 employees opted to retire under this scheme. This has been followed up with simplification of work procedures and automation of work processes.

• Governance

– The CBSL established advisory technical committee systems to streamline the decision-making process. Committees have been appointed to advise and recommend to the Monetary Board on monetary policy, financial system stability and auditing.

– The Monetary Board was enhanced by increasing its membership from 3 to 5, which facilitated two more private sector representatives in the Board.

– The Bank adopted International Accounting Standards for its accounts, which facilitated a comparable and acceptable disclosure policy and brought the accounts in line with international best practices.

During 2003, further progress was made in the modernisation project. Some of the key areas which were concluded during the year are as follows:

- New Human Resource and Training Policies
 - The CBSL recruited a consultant to advise and implement new human resource policies for the Bank. In this process, a blueprint was completed in the areas of performance evaluation and progress was made with regard to the updating of the Human Resources Manual.
 - With the aim of building the skills and the competence of staff continuously, comprehensive training opportunities have been provided in accordance with the training plan prepared by the Bank. This plan has been formulated with the objective of converting CBSL to a 'learning organisation', so that skills upgrading

BOX II – 1 (Contd.)

- would be done by the employees themselves in a sustainable manner.
- The Management Development Centre continued with its activities of providing High Level Training to the bank staff and public sector officials, by organising programmes based on a ‘demand-driven’ approach.
 - Capacity Building
 - Financial Sector Stability – Being a core objective of the Bank, it is important to ensure that the Bank Supervision Department (BSD) is well-geared in its supervisory functions of banks. Accordingly, the CBSL contracted the services of a consultant to strengthen the BSD, with the aim of ensuring the development of a sound banking sector in Sri Lanka. With this assistance, BSD is in the process of updating its prudential regulations to international standards and strengthening its on-site and off-site supervisory functions. The staff of the department have also been provided continuous training to enable them to perform their supervisory functions effectively.
 - E-mail and Internet Facilities – In keeping with the modern era of office automation, the Bank has made available e-mail facilities to the entire staff and provided easy access to Internet facilities.
 - Legal Reforms – The assistance of legal experts from the World Bank and the International Monetary Fund was obtained for a comprehensive review of the Monetary Law Act (MLA) and the Banking Act (BA). The CBSL intends to introduce a new Central Banking Act, which will replace the existing MLA, and a new BA to replace the existing banking legislation.
 - Accounting and Auditing – The CBSL continued to prepare its accounts based on International Accounting Standards and audited in terms of the International Financial Reporting Standards. The Bank has also adopted a new internal audit charter to have its accounts on a comparable basis with other central banks and to be in line with international best practices.
 - Technological Improvements
 - Real Time Gross Settlement (RTGS) System - The Bank implemented a RTGS system in September 2003. The RTGS system facilitates large value fund transfers and settlement on an electronic basis in real time rather than settling at the end of the day. It expedites fund transfers among banks, primary dealers, financial institutions, investors, customers, the government and the public. This system will also bring about greater financial discipline in the banking sector, since banks will have to maintain adequate cash and reserves in their accounts to meet their payment obligations, as the system will instantaneously update their settlement accounts after each transaction. This will improve the liquidity management of banks as treasurers and fund managers will have to produce accurate estimates of their liquidity requirements.
 - Scripless Securities Settlement (SSS) System – A major component of the work relating to the SSS system was completed during 2003. In February 2004, the SSS module was integrated with the RTGS system. To facilitate operations, government securities were issued in scripless form with effect from 30 January 2004. The SSS system would facilitate the issue of scripless securities, and their transfer among investors with a simultaneous settlement of funds through the RTGS on a Delivery versus Payment basis (DvP settlement). Sri Lanka’s integrated RTGS/SSSS will be known as “LankaSettle”. Since the system will operate electronically and on-line, dealing in government securities will be convenient to all market participants, *i.e.* primary dealers, banks and investors. The Central Depository System (CDS) will be the title registry as well as the custodian for government securities. The ownership of securities will be recorded electronically in the CDS. The holders of scripless securities in the CDS will be issued confirmations of transactions as well as periodic accounts statements of their holdings. The SSSS and CDS have been brand-named ‘LankaSecure’.
 - Treasury Dealing Room Management System (TDRMS) – The Bank also completed work relating to TDRMS during the year. The system went live in January 2004, and will facilitate deal capture, authorisation, risk management and settlement of foreign exchange and fixed income securities.
 - General Ledger (GL) System - The automation of GL was completed during the year and the system went live in August 2003. This has replaced the manual and semi-automated system adopted by the Bank, which was also decentralised in several departments. This has helped the creation of an effective Budgeting and Management Information System.
 - Divestment of Agency Functions
 - EPF and ETF – The work relating to the amalgamation of EPF and ETF progressed satisfactorily and a consultancy firm was assigned the task of studying and recommending the most feasible method of

BOX II – 1 (Contd.)

amalgamating these two institutions. The draft final report has been submitted in early 2004.

- RDBs – The CBSL divested the majority of its shares in the RDBs to the Treasury and currently holds only 20 per cent of the shares.

Future Activities

The future areas that would be addressed by this programme will include the Cheque Imaging and Truncation Project, which will facilitate efficient and speedy processing and clearing of cheques around the island. The Bank will also perform an internal information system audit which will

include a comprehensive audit of the new automated systems introduced by the Bank under the Modernisation Programme.

Funding Sources

The World Bank, through the International Development Agency (IDA) and Swedish International Development Co-operation Agency (SIDA), has provided a sum of US dollars 25.3 million and US dollar 1 million, respectively, to implement the Modernisation Programme. The CBSL intends to complete this programme by mid-2005.

Accounts and Finance**1. Accounting Framework and Policies, Financial Statements and notes thereto for year ended 31.12.2003****a. Basis of Presentation**

With effect from 2001, the Central Bank has adopted International Accounting Standards (IAS) as the accounting framework for producing its financial statements in order to make its financial statements internationally comparable and adopt disclosure and accounting policies in line with best international practices. Though this was a complete departure from the hitherto adopted financial reporting system, the Bank was able to achieve substantial IAS compliance in 2001, 2002 and 2003 and intends to complete the full compliance in 2004.

The following accounting policies were in force during 2002 and 2003 to ensure consistency for comparative purposes.

b. General

As a part of the on-going modernisation process, the Central Bank of Sri Lanka (Bank) has focused attention on improving its financial reporting and accounting practices to conform to international best practices. Accordingly, the Bank has prepared the accompanying financial statements in compliance with International Accounting Standards (IAS) for the third consecutive year.

The accompanying financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as stipulated under IAS with the exception of certain non-compliances described in the Statement of Accounting Policies, which comprise standards and interpretations approved by the International Accounting

Standard Board (IASB), and International Accounting Standards and Standing Interpretations Committee interpretations approved by the International Accounting Standards Committee (IASC) that are in force.

The financial statements are for the Bank as a single entity, and do not include consolidated financial statements for the Bank and its subsidiaries as required under IAS. The Bank commonly acts as agent and in other fiduciary capacities that result in the holding or placing of assets and liabilities on behalf of the Government of Sri Lanka and other state controlled entities. Such assets and liabilities administered by the Central Bank of Sri Lanka under custodial and administration arrangements are not assets and liabilities of the Bank and, therefore, are not included in the accompanying financial statements.

c. Statement of Accounting Policies**(i) Reporting Entity and Statutory Base**

These are the financial statements of the Central Bank of Sri Lanka (Bank or CBSL), an institution established under the Monetary Law Act, No. 58 of 1949 as amended from time to time, as the authority responsible for the administration, supervision and regulation of monetary, financial and payment system of Sri Lanka. These statements apply to the financial year ended 31 December 2003. They have been prepared in accordance with International Financial Reporting Standards (IFRS), which comprise standards and interpretations approved by the IASB, and International Accounting Standards (IAS) and Standing Interpretations Committee interpretations (SIC) approved by the IASC. However, the financial statements do not fully comply with the requirements of:

- IAS 7: Cash Flow Statements
- IAS 27: Consolidated Financial Statements

CENTRAL BANK OF SRI LANKA

Income Statement

For the Year ended 31 December 2003

	Note	2003 December (Rs. '000)	2002 December (Rs. '000)
OPERATING INCOME :			
Income from Foreign Currency Financial Assets			
Interest Income	15	5,100,891	3,915,717
Gain (Loss) from Unrealized Price Revaluations		(1,873,732)	3,793,359
Gain (Loss) from Realized from Price Changes		1,411,203	2,642,735
Total Income from Foreign Currency Financial Assets		4,638,362	10,351,811
Expense on Foreign Currency Financial Liabilities			
Interest Expenses	16	(915,352)	(966,346)
Total Expense on Foreign Currency Financial Liabilities		(915,352)	(966,346)
Net Foreign Exchange Revaluation Gain		6,903,079	3,466,518
Foreign Currency Investment Income		10,626,089	12,851,983
Income from Local Currency Financial Assets			
Interest Income	15	4,015,854	7,403,230
Interest Expense		(986,032)	(540,766)
Total Income from Local Currency Financial Assets		3,029,822	6,862,464
Other Income	17	1,053,786	321,233
Total Net Operating Income		14,709,697	20,035,680
OPERATING EXPENSES :			
Personnel Expenses	18	(1,822,573)	(1,069,059)
Depreciation		(422,530)	(168,647)
Decrease from Revaluation of Property Plant & Equipment		–	(721,284)
Cost of Inventory		(1,064,409)	(661,867)
Allowance for Impairment of Property Plant & Equipment		–	(2,206)
Administration	19	(384,884)	(872,409)
Bad & Doubtful Debts and Net Sundry Write Offs		(8,598)	(22,328)
Total Operating Expenses		(3,702,994)	(3,517,800)
Profit from Operating Activities before Income Tax		11,006,703	16,517,880
Income Tax		(188,397)	(529,069)
Net Profit from Ordinary Activities		10,818,306	15,988,811

CENTRAL BANK OF SRI LANKA

Balance Sheet

As at 31 December 2003

	Note	Year ended Dec 2003 (Rs. '000)	Year ended Dec 2002 (Rs. '000)
ASSETS			
Foreign Financial Assets			
Cash Balances		77,940,229	55,873,107
Foreign Currency Trading Securities	1	84,932,644	92,373,117
Gold	1	6,654,602	7,955,458
Foreign Currency Available For Sale Securities	1	49,329,149	—
Receivables		82,670	91,046
IMF Related Assets	2	59,486,061	54,588,730
		<u>278,425,355</u>	<u>210,881,458</u>
Local Financial Assets			
Sri Lanka Government Securities		33,182,981	52,859,539
Loans to Government	3	31,203,900	31,033,000
Loans to Other Institutions	4	29,878	30,000
Receivables		705,415	398,145
Investments in Financial and Other Institutions	5	599,529	663,091
		<u>65,721,703</u>	<u>84,983,775</u>
Other Assets			
Inventory	6	497,491	760,344
Gold Inventory		59,766	425,780
Sundry Assets		1,324,063	1,335,085
Property, Plant and Equipment	7	8,554,160	8,127,448
		<u>10,435,480</u>	<u>10,648,657</u>
		<u>354,582,538</u>	<u>306,513,890</u>
LIABILITIES			
Foreign Financial Liabilities			
Amount Payable to Bank and Financial Institutions	8	5,616,874	2,711,691
Amount Payable to Asian Clearing Union		17,603,949	13,029,377
IMF Related Liabilities	9	100,784,234	87,378,408
Other Foreign Liabilities		31,668	122,969
		<u>124,036,725</u>	<u>103,242,445</u>
Local Financial Liabilities			
Deposits – Commercial Banks and Financial Institutions	10	42,641,572	38,085,774
Deposits – Government & Government Entities	11	1,229,705	769,004
Treasury Bills & Bonds (Repurchase)		20,974,201	11,155,685
Deposits with Employee Benefit Plans	12	152,168	193,849
Payables		686,894	459,844
		<u>65,684,540</u>	<u>50,664,156</u>
Other Liabilities			
Currency in Circulation		98,784,636	88,307,773
Deferred Government Grants		588,781	—
Provisions		1,012,795	335,804
Miscellaneous Liabilities	13	331,364	362,965
		<u>100,717,576</u>	<u>89,006,542</u>
Capital & Reserves	14	<u>64,143,697</u>	<u>63,600,747</u>
		<u>354,582,538</u>	<u>306,513,890</u>

OPINION OF THE AUDITOR GENERAL

The accounts of the Central Bank of Sri Lanka for the year ended 31 December 2003 were audited under my direction in pursuance of provision in Article 154 of the Constitution of the Democratic Socialist Republic of Sri Lanka read in conjunction with Section 13 of the Finance Act No.38 of 1971 and Section 42(1) of the Monetary Law Act, No.58 of 1949.

Except for the effects on the financial statements of the matters referred to in paragraph 2.2 of my report, I am of opinion that the financial statements have been satisfactorily prepared to present fairly in all material respects, the financial position of the CBSL as at 31 December 2003 and results of its operations for the year then ended in accordance with the International Accounting Standards (IAS) and the stated accounting policies as set out in Notes 1 to 44 to the financial statements.

In terms of Section 42(2) of the Monetary Law Act, my observations on these accounts are contained in my report of even date addressed to the Honourable Minister of Finance.

Auditor General's Department

Colombo 7.

22nd March 2004

S. C. Mayadunne
Auditor-General

A. S. Jayawardena
Governor

D. L. Katuwawala
Chief Accountant

CENTRAL BANK OF SRI LANKA

Cash Flow Statement As at 31 December 2003

	Note	2003 (Rs. '000)
CASH FLOW FROM OPERATING ACTIVITIES :		
Source:		
Interest Received – Foreign Currency		4,352,505
Interest Received – Local Currency – Others		68,740
Liquidity Management and Trading Income		1,411,203
Realised Exchange Gain / (Loss)		(359,933)
Fees, Commission and Other Miscellaneous Income Received		761,815
		<hr/>
		6,234,330
Disbursements:		
Interest Paid – Foreign Currency		921,403
Interest Paid – Local Currency		986,032
Payments to Employees		975,045
Payments to Suppliers		1,161,205
Income Tax Paid		188,397
		<hr/>
		4,232,082
Net Cash Flow from Operating Activities	20	2,002,248
CASH FLOWS FROM INVESTING ACTIVITIES :		
Source:		
Net (Increase) / Decrease in Other Local Currency Financial Assets		(65,576)
Principal recoveries from the Loans and Advances to Other Institutions		121
Disposal / Redemption of Investments in Financial and Other Institutions		43,563
Sale of Property, Plant and Equipment		567
Income on Investments in Financial and Other Institutions		117,953
Net Increase in Securities Purchased under Agreement to Re-sell		9,818,516
		<hr/>
		9,915,144
Disbursements:		
Net Increase / (Decrease) in Foreign Currency Marketable Securities		38,025,386
Net Increase / (Decrease) in Other Foreign Currency Financial Assets		(170,732)
Net Increase / (Decrease) in Other Foreign Currency Financial Liabilities		(9,948,239)
Net Increase / (Decrease) in Other Local Deposits		41,680
Purchase of Property, Plant and Equipment net of Grants		260,702
		<hr/>
		28,208,797
Net Cash Flow from Investing Activities		(18,293,653)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Source:		
Issue of Circulating Currency		108,826,986
Withdrawal of Circulating Currency		(98,350,124)
Net Issue of Circulating Currency		10,476,862
Less:		
Net Issue / (Withdrawals) of Circulation Currency on Government Transactions	21	(23,867,571)
Net Issue / (Withdrawals) of Circulation Currency on Bank and Financial Institutions Transactions	22	(4,555,797)
Net Issue / (Withdrawals) of Circulating Currency		<hr/>
		38,900,230
Additional Foreign Currency Term Liabilities		7,197,831
		<hr/>
		46,098,061
Disbursements:		
Repayment of Foreign Currency Term Liabilities		2,869,497
Payments of Surplus to Government		10,000,000
		<hr/>
		12,869,497
Net Cash Flow from Financing Activities		33,228,564
Net Increase in Cash and Cash Equivalents		16,937,159
Plus Exchange Rate Effect on Cash and Cash Equivalents		5,129,963
Cash and Cash Equivalent at 1 January		55,873,107
Cash and Cash Equivalent at 31 December	23	77,940,229

CENTRAL BANK OF SRI LANKA

Notes to the Financial Statements

As at 31 December 2003

	2003 December (Rs. '000)	2002 December (Rs. '000)
Note 1 – Foreign Currency Securities		
Foreign Currency Trading Securities	84,932,644	92,373,117
Trading Securities Denominated in Gold	6,654,602	7,955,458
Foreign Currency Available-for-Sale Securities	49,329,149	–
Total Foreign Currency Trading and Available for Sale Securities	140,916,395	100,328,575
Note 2 – IMF Related Assets		
Holding in Special Drawing Rights	59,811	226,625
IMF Quota	59,426,250	54,362,105
Total IMF Related Assets	59,486,061	54,588,730
Note 3 – Loans to Government		
Revolving Credit	31,203,900	31,033,000
Total Loans to Government	31,203,900	31,033,000
Note 4 – Loans to Other Institutions		
Capital Outstanding	2,626,658	2,656,684
Interest Receivable	4,349,153	3,967,675
Gross Receivable	6,975,811	6,624,359
<i>Less : Allowance for Doubtful Receivables</i>	(2,596,780)	(2,626,684)
<i>Suspended Interest</i>	(4,349,153)	(3,967,675)
Net Receivable	29,878	30,000
Movement in Allowance for Doubtful Receivables is as follows :		
At the beginning of the year	2,626,684	2,689,246
Allowances made during the year	–	–
Bad debt recoveries	(29,904)	(62,562)
At the end of the year	2,596,780	2,626,684
Note 5 – Investments in Financial and Other Institutions		
Regional Development Banks	517,469	560,969
Sri Lanka Export Credit Insurance Corporation Ltd.	–	20,000
Credit Information Bureau Ltd.	12,310	12,372
National Development Bank Ltd.	26,250	26,250
Fitch Ratings Lanka Ltd.	3,500	3,500
NDB Bank Ltd.	10,500	10,500
LankaClear (Pvt) Ltd.	29,500	29,500
Total Investments in Financial and Other Institutions	599,529	663,091
Note 6 – Inventories		
Notes for Circulation	286,002	683,606
Coins for Circulation	248,723	132,431
<i>Less : Allowance for slow moving items</i>	(64,700)	(64,700)
Stationery and Sundry Inventory	534,725	816,037
Total inventories at lower of cost and net realisable value	470,025	751,337
	27,466	9,007
	497,491	760,344

Note 7 – Property Plant and Equipment

Carrying Value	Land and Buildings (Rs. '000)	Equipment (Rs. '000)	Office Furniture & Fixtures (Rs. '000)	Motor Vehicles (Rs. '000)	Others (Rs. '000)	Total 2003 (Rs. '000)	Total 2002 (Rs. '000)
At 1st January, net of Accumulated Depreciation	7,793,752	109,294	169,695	51,404	3,303	8,127,448	8,021,398
Additions	4,010	825,076	16,066	–	4,332	849,484	400,970
Disposals, net of Accumulated Depreciation	–	–	(205)	–	–	(205)	(65,166)
Effects of Changes in Accounting Estimates	–	(19,058)	(9,327)	(51,404)	–	(79,789)	–
Gain on revaluation	–	–	–	–	–	–	662,382
Loss on revaluation	–	–	–	–	–	–	(721,283)
Allowance for Impairment	–	–	–	–	–	–	(2,206)
Depreciation charge for the year	(114,584)	(201,687)	(24,782)	–	(1,725)	(342,778)	(168,647)
At 31st December net of Accumulated Depreciation	7,683,178	713,625	151,447	–	5,910	8,554,160	8,127,448

2003 December (Rs. '000)	2002 December (Rs. '000)
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Note 8 – Amount Payable to Banks and Financial Institutions

Payable to Banks	5,439,958	2,361,981
Payable to Others	176,916	349,710
	5,616,874	2,711,691

Note 9 – IMF Related Liabilities

Foreign Currency IMF Related Liabilities		
Interest Bearing Loans – Non-Current	33,525,734	27,036,403
Interest Bearing Loans – Current	4,519,140	2,945,600
Allocation of Special Drawing Rights	10,187,275	9,319,143
Other amounts payable to IMF	27,037,469	22,350,931
Quota Liability	25,514,616	25,726,331
	67,258,500	60,342,005
Total IMF Related Liabilities	100,784,234	87,378,408

Note 10 – Balances with Banks and Financial Institutions

Balances with Banks and Financial Institutions	45,663,572	38,085,774
Less : Advances under Intra-day Liquidity Facility	(3,022,000)	–
Total Balances with Banks and Financial Institutions	42,641,572	38,085,774

Note 11 – Balances with Government and Government Entities

Government Deposits	568,906	200,749
Government Agencies and Funds	660,799	568,255
Total Balances with Government and Government Entities	1,229,705	769,004

Note 12 – Balances with Employee Benefit Plans

Provident Fund	107,466	159,979
Pension Fund	38,767	32,004
Widow & Orphans Fund	5,935	1,866
Total Balances with Employee Benefit Plans	152,168	193,849

Note 13 – Provisions

Credit Guarantees	168,673	225,685
Employee retirement Pension Scheme	712,006	175,560
W& OP Plans	121,624	(68,530)
Gratuity	10,492	3,089
Total Provisions	1,012,795	335,804

	2003 December (Rs. '000)	2002 December (Rs. '000)
Note 14 – Equity		
Contributed Capital	15,000	15,000
Medium and Long Term Credit Reserve	4,925,000	4,925,000
Surplus	985,000	985,000
Capital Contribution Account	577,859	577,859
Fixed Asset Revaluation Account	662,382	662,382
Market Valuation Reserve	(275,356)	–
General Reserve	42,760,507	40,446,695
Profit for the Year	10,818,305	15,988,811
International Revaluation Reserve	3,675,000	–
Total	64,143,697	63,600,747
Note 15 – Interest Income from Financial Assets		
Interest Income from Foreign Currency Financial Assets		
Cash Equivalents	1,383,832	1,148,303
Marketable Securities	3,665,204	2,689,066
International Monetary Fund	51,855	78,348
Total Interest Income from Foreign Currency Financial Assets	5,100,891	3,915,717
Net Interest Income from Local Currency Financial Assets		
Investment Portfolio – Sri Lanka Government Securities	3,901,213	7,295,716
Interest Income on Debentures in RRDBs	45,901	48,116
Other Loans and Advances	68,740	59,398
Total Net Interest Income from Local Currency Financial Assets	4,015,854	7,403,230
Total Net Interest Income from Financial Assets	9,116,745	11,318,947
Note 16 – Interest Expense on Foreign Currency Financial Liabilities		
Asian Clearing Union	92,070	105,713
International Monetary Fund	823,282	860,633
Total Interest Expense on Foreign Currency Financial Liabilities	915,352	966,346
Note 17 – Other Income		
Dividend Income	78,169	49,172
Gain on Disposal of Property Plant and Equipment	363	28,556
Gain on Disposal of Investments in Financial and other Institutions	213,257	10,598
Amortisation of Deferred Grant	148,710	–
Miscellaneous Income	613,287	232,907
Total Other Income	1,053,786	321,233
Note 18 – Personnel Expenses		
Wages and Salaries including PAYE paid by the employer	850,837	626,779
Pension Costs	627,852	246,020
Other Defined Benefit Plan Costs	211,070	213
Defined Contribution Plan Costs	132,814	196,047
Total Personnel Expenses	1,822,573	1,069,059
Note 19 – Administration		
Repairs and Maintenance	210,125	221,343
Information	57,639	53,809
Operational Travel	–	13,781
Rental Expenses	15,633	22,355
Printing	36,147	41,127
Audit Fees payable to Auditor-General	825	750
Advance for Irrecoverable Cash Balances	–	20,093
Remuneration to members of the Monetary Board	560	287
Miscellaneous	63,955	498,864
Total Administration Expenses	384,884	872,409

	2003 December (Rs. '000)
Note 20 – Reconciliation of Operating Profit with Operating Cash Flow	
Reported Net Profit from Operating Activities	10,818,305
Add (Subtract) Non-Cash Items	
Depreciation	422,567
Interest Received – Local Currency – Investment Portfolio	(4,807,971)
Bad Debt Write-Off	8,598
Net Provision for Defined Employee Benefits Plans	676,991
Net Unrealised Foreign Exchange (Gain) / Loss	(7,263,012)
Add (Subtract) Movements in Other Working Capital Items	
(Increase) / Decrease in Inventories	262,854
(Increase) / Decrease in Interest Receivable	155,484
Increase / (Decrease) in Miscellaneous Liabilities	195,448
Increase / (Decrease) in Interest Payable	(3,162)
Add (Subtract) Investing and Financing Activities	
Income from Investments	(337,585)
Net Unrealised Market Value Changes	1,873,731
Net Cash Flow from Operating Activities	2,002,248
Note 21 – Issues / (Withdrawals) of Circulation Currency on Government Transactions	
Maturity of Government of Sri Lanka Securities Portfolio	(66,146,340)
Purchases of Government of Sri Lanka Securities for Investment Portfolio	47,376,541
Interest Received – Local Currency – Investment Portfolio	(4,807,971)
Increase / (Decrease) in Loans and Advances to GOSL	170,900
(Increase) / Decrease Balances with Government and Government Entities	(460,701)
	(23,867,571)
Note 22 – Net Issues / (Withdrawals) of Circulation Currency on Bank and Financial Institutions Transactions	
(Increase) / Decrease in balances with Banks and Financial Institutions	(7,577,797)
(Increase) / Decrease Intra-day Liquidity Facility to Banks and Financial Institutions	3,022,000
	(4,555,797)
Note 23 – Closing Cash Balances	
Foreign Currency Assets	
Cash Balances with Other Foreign Banks	77,940,229
Closing Cash Balances	77,940,229

(Since this is the first time the Bank prepared a cash flow statement, it is not practicable to produce comparative information.)

- IAS 32: Financial Instruments: Disclosure and Presentation
- IAS 39: Financial Instruments: Recognition and Measurement

(ii) Measurement Base

The financial statements are prepared on the historical cost basis, modified by the revaluation of certain assets and liabilities as identified in specific accounting policies below.

(iii) Currency of Presentation

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

(iv) Changes in Accounting Policies

The Bank adopted trade date accounting for all financial assets resulting from ‘regular way’ purchases and sales as in view of the management, trade date accounting improves the fair presentation of the asset and liability position of the bank. Regular purchases and sales were earlier recognised on settlement date basis. All other policies have been applied on a basis consistent with the prior year. The change in the accounting policy was retrospectively adjusted. To ensure consistency with the current year, comparative figures have been restated where appropriate.

Previously, when the Bank contracted to buy financial assets on terms that required delivery of the asset within a time frame established by market place convention, the fixed price commitment between trade date and settlement date was recorded as a derivative.

	Foreign currency Trading Securities	Trading Securities denominated in gold	Amount Payable to Banks and Financial Institutions
	Note 1	Note 1	Note 8
Balance as previously stated at 01 January 2003	90,851,682	7,114,912	349,710
Effect of change in accounting policy:			
– Increase in financial assets	1,521,435	840,546	2,361,981
– Increase in financial liabilities	–	–	–
Re-stated Balance	92,373,117	7,955,458	2,711,691

As a result of this change in accounting policy, financial assets, which the Bank is committed to purchase, are carried at fair value. The fair value of these financial assets at 31 December 2003 is Rs.5,439,958 (2002-Rs.2,361,981). The change in fair value is accounted for in compliance with the respective accounting policies for the recognition of fair value gains and losses of the resultant financial assets. The corresponding liabilities are accounted for similarly to the financial assets and recorded as amounts payable to Bank and Financial Institutions.

The effect of the change in Accounting Policy on the comparative figures is shown above.

(v) Foreign Currency Conversions

Transactions in foreign currencies have been translated to Sri Lanka rupees using exchange rates applying on the trade date of transactions. 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:

	2003	2002
Euro	121.6048	101.3823
Sterling pounds	172.1988	155.1227
Indian rupees	2.1247	2.0176
Japanese yen	0.9044	0.8164
United States dollars	96.7382	96.725
Special Drawing Rights (SDR)	143.75	131.50

(vi) 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, investment of the proceeds of 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 investments are initially recognised at cost, being the fair value of the consideration given and including acquisition charges associated with the investment. After initial recognition, subsequent measurement bases are described below. All regular way purchases and sales of financial assets are recognised on the trade date. 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.

(vii) Foreign Currency Trading Securities

Foreign currency trading securities are subsequently valued at quoted market prices. Changes in market value are recognised as an increase or decrease in the value of the trading securities in the Balance Sheet, while resultant 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.

(viii) Foreign Currency Available-for-Sale Securities

Foreign currency available-for-sale securities 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.

Gains and losses arising from changes in the market value of foreign currency available-for-sale securities are recognised on a separate component of equity 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.

(ix) Trading Securities – Gold

Gold securities held with foreign counter-parties is initially stated at cost. Changes in market value are recognised as an increase or decrease in the value of the gold in the Balance Sheet.

Gains and losses arising from changes in the market value of gold are recognised in the Income Statement. Where the gold 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 gold), this is reported as Gain (Loss) Realised from Price Changes.

(x) International Monetary Fund 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.

Quota with the IMF is recorded by the Bank as an asset and the amount payable to the IMF for quota is recorded as a liability of the Bank. The cumulative allocation of SDRs by the IMF is treated as a liability. Exchange gains and losses arising on revaluation of IMF assets and liabilities at the exchange rate applying at 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.

(xi) Cash and Cash Equivalents

Cash and cash equivalents comprise cash at foreign banks and financial institutions and short-term deposits with an original maturity of three months or less.

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 as well and mainly comprise the transactions with GOSL and transactions with domestic banks and financial institutions. Transactions with GOSL basically represent the purchase of un-subscribed portions of Treasury bills and bonds that are issued by the government by the Bank as a mechanism to control liquidity. Such purchases, disposals or interest thereon are reflected as mere book entries in the records of CBSL.

As the sole statutory authority, CBSL issues currency to the public in line with the 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 balances with commercial banks. Such forms of utilisation 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 outstanding bank overdrafts.

(xii) Repurchase and Reverse-Repurchase Transactions

Securities sold under agreements to repurchase continue to be recorded as trading or available for sale securities 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 is expensed 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.

(xiii) Investment Portfolio – Sri Lanka Government Securities

The Bank's investment portfolio consists of Treasury bills purchased from the Government of Sri Lanka. The portfolio is recorded in the Balance Sheet at amortised cost since they represent loans originated by the Bank.

(xiv) Loans to Government

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

(xv) Loans to Other Institutions

Loans granted to Other Institutions are recognised and carried at the original granted amount less an allowance for any uncollectable 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 provision is the difference between the carrying amount, and the estimated recoverable amount. Bad debts are written off when identified.

(xvi) Foreign Currency Term Liabilities

Foreign currency term liabilities are subsequently reported at 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.

(xvii) 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 are reported within the balance of foreign currency trading or available for sale securities in the Balance Sheet.

(xviii) Other Financial Assets and Liabilities

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

(xix) Investment in Associates

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

(xx) Gold Inventory

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

(xxi) Inventories

Inventories are carried at lower of cost or realisable value. Cost is determined on a First in First Out basis. Allowance is made for slow moving inventories.

(xxii) Property, Plant and Equipment

All items of property, plant and equipment are initially recorded at cost. Land and buildings are subsequently re-valued, on an asset-by-asset basis, to their fair values. Revaluations are made with sufficient regularity to ensure that their carrying amount does not differ materially from their fair value at the balance sheet date.

The carrying amounts, both those re-valued and those measured at cost, are reviewed at each balance sheet date to assess whether they are recorded in excess of their recoverable amount, and if carrying values exceed this recoverable amount, assets are written down.

When an asset is revalued, any increase in the carrying amount is credited directly to a revaluation reserve unless it reverses a previous revaluation decrease relating to the same asset which was previously recognised as an expense. In these circumstances, the increase is recognised as income to the extent of the previous write down. When an asset's carrying amount is decreased as a result of a revaluation, the decrease is recognised as an expense unless it reverses a previous increment relating to that asset, in which case it is charged against any related revaluation reserve, to the extent that the decrease does not exceed the amount held in the revaluation reserve in respect of that same asset. Any balance remaining in the revaluation reserve in respect of an asset, is transferred directly to retained earnings on retirement or disposal of the asset.

Depreciation is calculated on a straight line method over the following estimated useful lives.

Buildings	50 Years
Motor Vehicles	10 Years
Office Furniture and Equipment	10 Years
Equipment	4 Years – 5 Years
Others	3 Years

Expenditure incurred on repairs or maintenance of property, plant and equipment in order to restore or maintain the future economic benefits expected from originally assessed standard of performance, is recognised as an expense when incurred.

(xxiii) Accounts Receivable

Accounts receivable are carried at expected realisable value after making due allowance for doubtful debts.

(xxiv) Sundry Assets

Sundry assets are carried at expected realisable values.

(xxv) 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

(xxvi) 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.

(xxvii) Employee Benefits

Pensions

The Bank operates a defined benefit pension scheme for employees who had joined the Bank before 01 January 1998. The pension scheme is not open to the new entrants to the Bank from 01 January 1998. This is a non-contributory pension scheme, where the cost of benefits is wholly borne by the Bank. Contributions are made by the Bank to a separately administered fund. The cost of providing benefits under this plan is determined using the projected unit credit actuarial valuation method. Actuarial gains and losses are recognised as income or expense when the cumulative unrecognised actuarial gains or losses for each individual plan exceed 10 per cent of the higher of defined benefit obligation and the fair value of plan assets. These gains or losses are recognised over the expected average remaining working lives of the employees participating in the plans.

Retirement Gratuity

The Retirement Gratuity is a Defined Benefit Plan. The Bank is liable to pay gratuity for the employees who are not eligible for the pension scheme. In order to meet this liability, a provision is carried forward in the balance sheet, equivalent to an amount calculated using a formula based on a half month's salary of the last month of the financial year of eligible employees for each completed year of service, commencing from the first year of service. The resulting difference between the brought forward provision at the beginning of a year and the carried forward provision at the end of a year represent a charge to the income statement. The gratuity liability is neither funded nor actuarially valued. This item is grouped under Provisions in the Balance Sheet.

Employees' Provident Fund and Employees' Trust Fund

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

(xxviii) Grants

Grants are 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.

(xxix) Personnel Expenses

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

(xxx) 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.

(xxxi) Income Tax

The income of the Bank other than interest or discount payable or allowable by the Bank on any deposit money including Treasury bills, Treasury bonds, is exempt from tax under Section 8 (a) xxii of the Inland Revenue Act, No. 38 of 2000.

As per the Inland Revenue (Amendment) Act, No. 10 of 2002, such interest or discount payable will be liable to 10 per cent withholding tax at the time of payment or crediting of such interest.

(xxxii) 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.

(xxxiii) Revenue and 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 and equipment in a state of efficiency has been charged to income in arriving at the profit for the year.

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

(A) 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. Interest income includes coupons earned on fixed income investment and trading securities and accrued discount and premium on treasury bills and other discounted instruments. Interest income is suspended when loans become doubtful of collection. Such income is excluded from interest income until received.

(B) Dividends

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

(C) 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. On disposal of revalued property, plant & equipment, any amount remaining in Revaluation Reserve relating to that asset is transferred directly to Accumulated Profit.

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.

(xxxiv) Segmental Reporting

The Bank presents financial assets and financial liabilities, and their associated income and expense streams, by distinguishing

between foreign currency and local currency activities. The Bank considers that this reporting approach provide appropriate segmental reporting of the Bank's activities which are more fully described below.

(xxxv) Nature and Extent of Activities

The Monetary Board of the Central Bank of Sri Lanka shall, in addition to determining the policies or measures authorised to be adopted or taken under Monetary Law Act, No. 58 of 1949, as amended, be 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.
- Organisation 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.

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 ('foreign reserves') other foreign currency assets held for trading purposes.

The foreign currency assets are held in various currencies. The majority are denominated in United States dollars, euros, sterling pounds and Japanese yen. The financial instruments held within these foreign currency portfolios consist mainly of sovereign securities, securities held under reverse-repurchase transactions or balances held with other central banks, commercial banks and settlement institutions.

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

As part of the active management of its foreign currency operations, the Central Bank of Sri Lanka enters into security repurchase transactions. The repurchase agreements continue to be recorded as assets in the Bank's Balance Sheet.

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 and representing the investment of the Central Bank of Sri Lanka's net equity. The Bank's policy is to hold these investments for monetary operations.

2. Assets / Liabilities 2003

The total Assets and Liabilities of the Central Bank stood at Rs.354.6 billion, respectively, at the end of 2003 compared with Rs.306.5 billion at the end of 2002, showing an increase of Rs.48.1 billion or 15.7 per cent during 2003. The increase in the assets of the Bank was reflected in increases in the foreign financial assets (by Rs.67.5 billion). However, local financial and other sundry assets of the Bank decreased by Rs.19.7 billion. This is due to the decrease in Treasury bills by Rs.19.7 billion, and increase in loans to government by Rs.0.2 billion.

The increase in the liabilities of the Bank (Rs.48.1 billion) was reflected in increases in foreign financial liabilities (by Rs.20.8 billion), currency in circulation (by Rs.10.5 billion), local financial liabilities (by Rs.15.1 billion), and other liabilities (by Rs.1.2 billion), capital and reserves (by Rs.0.5 billion).

a. Assets

(i) Foreign Financial Assets

Foreign financial assets comprised the largest category of assets, accounting for 78.5 per cent of total assets of the Bank, and recorded an increase of 32 per cent in 2002 compared with the level at the end of the previous year. The increase was partly due to the receipt of the Extended Fund Facility (EFF) and Poverty Reduction and Growth Facility (PRGF) of the IMF net of repayments and interest (USD 52.3 mn), net purchases of US dollars by CBSL from the local foreign exchange market to build up external reserves (US dollars 373.4 million), receipt of foreign loans raised by the government net of repayments of principal and interest, and also due to the increase in the rupee value of foreign assets arising from the depreciation of the rupee against major currencies during the year.

(ii) Local Financial Assets

Local financial assets, which account for 18.5 per cent of total assets of the Bank, declined from Rs.85 billion in 2002 to Rs.65.7 billion in 2003 or by 22.7 per cent, mainly due to the decrease in Treasury bills by Rs.19.7 billion. Also the investments in financial and other institutions declined by Rs.63.5 million as per details below:

Investments in Financial and Other Institutions

The Monetary Law Act, No. 58 of 1949 of Sri Lanka, as amended, specifically prohibits the CBSL from engaging in trade or otherwise having a direct interest in any commercial, industrial or other undertaking or to purchase shares of other banking institutions in the normal course of business. However, the Act authorises the Bank to acquire and hold shares in any company, which, in the opinion of the Monetary Board, was formed for the advancement and promotion of human resources and technological development in the banking and financial sector or to facilitate clearance transactions among commercial banks operating in Sri Lanka. Further, specific legislation relating to RDBs, NDB, CRB and SLECIC have enabled the Bank to invest in the equity of RDBs, NDB and SLECIC, and CRIB, respectively.

Based on the above requirements, the Bank holds the following investments:

Company	Business	% Holding		Year End
		2003	2002	
Ruhuna Development Bank Ltd.	Development banking	20	20	31 Dec
Rajarata Development Bank Ltd.	Development banking	20	20	31 Dec
Kandurata Development Bank Ltd.	Development banking	20	20	31 Dec
Wayamba Development Bank Ltd.	Development banking	20	20	31 Dec
Sabaragamuwa Development Bank Ltd.	Development banking	20	20	31 Dec
Uva Development Bank Ltd.	Development banking	20	20	31 Dec
Sri Lanka Export Credit Insurance Corporation Ltd.	Insurance of export credit	Nil	67	31 Dec
Credit Information Bureau of Sri Lanka Ltd.	Provision of credit information	50	50	31 Dec
National Development Bank Ltd.	Development financing	5	5	31 Dec
Fitch Ratings Lanka Ltd.	Credit rating	10	10	31 Dec
LankaClear (Pvt) Ltd.	Automated clearing	20	20	31 Mar
NDB Bank Ltd.	Commercial bank	2	2	31 Dec

The overall composition of the investments held by the Bank is as follows:

	2003 Rs.'000	2002 Rs.'000
Investments in shares in subsidiaries (including Regional Development Banks)	Nil	180,000
Investments in debentures of subsidiaries	337,469	400,969
Investments in shares in associates	192,310	12,372
Other Investments in shares	69,750	69,750
	559,529	663,091

The Monetary Board of the Bank on 29 December 2002 approved a transfer of a portion of equity shares in Regional Development Banks (RDBs) to the Government of Sri Lanka (GOSL) for divestiture through the Public Enterprises Reform Commission in a suitable manner and for remittance of the sale proceeds to the Bank. On 15 December 2003, the Bank and the GOSL signed 6 agreements to validate the share transfer and to assign the net assets value of the share holding as transfer price. Accordingly control over RDBs ceases to exist on this date. The residual investment in RDBs are held for subsequent disposal in the near future, and recorded at cost in the balance sheet. The transfer was recorded as a disposal of investments and a gain of Rs.213 million was recognised in the income statement during the year. The disposal proceeds receivable from GOSL upon the divesture, amounting to Rs.565 million (2002-Rs.352 million), has been included under Local Currency Financial Assets : Other Local Receivables.

The investment in Sri Lanka Export Credit Insurance Corporation Ltd. was disposed at cost effective from 21 July 2003.

b. Liabilities

(i) Foreign Financial Liabilities

Foreign financial liabilities account for 35 per cent of the total liabilities of the Bank. The IMF related liabilities in 2003 increased by Rs.13.4 billion or 15 per cent due to the receipt of EFF and PRGF facilities from the IMF, an increase in the amount payable to ACU and the revaluation of foreign currency liabilities.

(ii) Local Financial Liabilities

Local financial liabilities, which account for 18.5 per cent of total liabilities, increased by Rs.15 billion or 29.6 per cent during the year. The growth of domestic financial liabilities was mainly due to the increase of commercial bank deposits by Rs.4.5 billion, and Treasury bills and bonds (repurchase agreements) by Rs.9.8 billion.

(iii) Other Liabilities and Reserves

Other liabilities constituted the largest category of liabilities, accounting for 46.5 per cent of the total liabilities of the Bank.

Currency in circulation, which is the major item in the other liabilities, increased by Rs.10.5 billion or 11.9 per cent, from Rs.88.3 billion in 2002 to Rs.98.8 billion in 2003. The other liabilities increased by Rs.1.2 billion or 1.3 per cent from Rs.0.7 billion in 2002 to Rs.1.9 billion in 2003. The Capital and reserves increased by Rs.0.5 billion from Rs.63.6 billion in 2002 to Rs.64.1 billion in 2003.

c. Income

The operational income (net of interest payments) amounted to Rs.14.7 billion for the year compared to Rs.20 billion for the previous year. The major portion of this net operational income amounting to Rs.10.6 billion was generated by way of earned interest, realised price changes, unrealised price changes and net foreign exchange revaluation gain from foreign financial operations of the Bank. This compares with Rs.12.9 billion for the previous year, showing a decrease of Rs.2.3 billion. The decreased is mainly attributable to the decrease in market values of foreign securities held by the Bank that generated an unrealised loss of Rs.1.9 billion for the year under review, compared with an unrealised income of Rs.3.8 billion for the previous year. The net income recognised in the year in respect of the gains and losses arising out of the changes in exchange rates associated with foreign currency denominated transactions during the year and the year end translations of foreign currency denominated assets and liabilities amounted to Rs.6.9 billion, compared with Rs.3.5 billion for the previous year due to the depreciation of the value of the rupee against the major currencies.

The share of the income from local financial operations and other income amounted to Rs.4.0 billion compared with Rs.7.2 billion for the previous year. The decrease in local financial income is mainly due to the drop in the Treasury bill portfolio from Rs.52.9 billion in 2002 to Rs.33.2 billion in 2003.

d. Expenditure

The total operating expenditure of the Bank increased slightly by 5.7 per cent, from Rs.3.5 billion in 2002 to Rs.3.7 billion in 2003. Personnel expenses increased from Rs.1.07 billion in 2002 to Rs.1.82 billion in 2003, mainly due to the increased pension contribution cost following actuarial valuation. The cost of inventory increased by Rs.0.4 billion compared with the previous year due to the increase in the cost of currency stock.

e. General

The Bank has upgraded its financial reporting structure by way of introducing an extensive computerisation programme involving the General Ledger Systems and related sub-systems. The Real Time Gross Settlement system and the Central Depository system for local securities (scripless) are also linked up with the General Ledger Systems to give to the on-line update on the financial reporting system. These improvements

are meant to strengthen the Bank's ability to manage financial risk exposures on the one hand, and comply with the international best practices in the field of accounting and finance including standards, reporting and disclosures with regards to the financial statements, on the other.

Financial statements of the CBSL for year 2003 prepared on the basis of International Financial Reporting Standards (IFRS) are published as a separate document.

Bank Supervision

The regulatory and supervisory function of the Central Bank relating to banks licensed by the Monetary Board of the Central Bank is carried out by the Bank Supervision Department (BSD), with a view to ensuring the safety and soundness of the banking system and safeguarding the interests of depositors. Institutions that are currently regulated and supervised are Licensed Commercial Banks (LCBs) and Licensed Specialised Banks (LSBs). The functions of regulation and supervision, which are governed mainly by the Banking Act and the Monetary Law Act, include the issue of directions, determinations and orders under the statutes, issue of prudential directions and guidelines, granting approval for establishing and closing of banks, branches and other business outlets of banks, off-site and on-site examination of banks and the enforcement of regulatory actions and the resolution of weak banks. Apart from these, the BSD administers a voluntary Deposit Insurance Scheme and has responsibility for arranging and conducting the Governor's monthly meetings with Chief Executive Officers of LCBs and LSBs, and meetings of the Financial Sector Reforms Committee and the Financial Stability Committee. The BSD also undertakes public awareness programmes on the banking industry.

As at the end of 2003, 22 LCBs (11 local and 11 foreign) and 14 LSBs were in operation and carrying on business under the supervisory purview of the Central Bank. The names of the banks are listed below.

LCBs (in alphabetical order) : Bank of Ceylon, Citibank, N.A., Commercial Bank of Ceylon Ltd., Deutsche Bank AG, DFCC Vardhana Bank Ltd., Habib Bank Ltd., Hatton National Bank Ltd., Indian Bank, Indian Overseas Bank, Muslim Commercial Bank Ltd., Nations Trust Bank Ltd., NDB Bank Ltd., Pan Asia Bank Ltd., People's Bank, Public Bank Berhad, Sampath Bank Ltd., Seylan Bank Ltd., Standard Chartered Bank, State Bank of India, The Hongkong & Shanghai Banking Corporation Ltd., Union Bank of Colombo Ltd. and Union Bank Ltd. (Incorporated in Pakistan).

LSBs (in alphabetical order) : Ceylinco Savings Bank Ltd., DFCC Bank, Housing Development Finance Corporation Bank of Sri Lanka, Kandurata Development Bank, National

Development Bank of Sri Lanka, National Savings Bank, NDB Housing Bank Ltd., Rajarata Development Bank, Ruhuna Development Bank, Sabaragamuwa Development Bank, Sanasa Development Bank Ltd., State Mortgage & Investment Bank, Uva Development Bank, and Wayamba Development Bank.

The resolution of one LSB, Pramuka Savings & Development Bank Ltd., was continued in terms of the law.

Prudential Regulations and Directions

The BSD continued to monitor compliance by banks with regulatory requirements introduced from time to time under the provisions of the Banking Act and other prudential directions applicable to capital, liquidity, large exposures, share ownership in banks, investments in shares by banks, asset quality, income recognition, provisioning for bad and doubtful debts, related party transactions, acquisition of immovable property, disclosure of quarterly and annual financial statements and the audit of banks.

Directions and other Prudential Requirements issued during the year 2003

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

- i. Amendment to Schedule II, relating to Valuation of Securities for Provisioning Purposes, in the Directions on Suspension of Interest on Non-Performing Advances and Classification of Bad and Doubtful Advances for Provisioning Purposes. This amendment effected the following.
 - (a) At the time of first provisioning for a loan secured against a primary mortgage over property, only 75% of the forced sale value (FSV) of the property based on a current professional valuation report can be considered as the value of security.
 - (b) When a loan is transferred to the 'Loss' category, (*i.e.* where a loan has been non performing for 18 months or more) the following progressive discounts will apply to the FSV of immovable property held as collateral, based on a current professional valuation report. A current professional valuation report is a report that is not more than four years old in respect of loans for residential purposes granted against residential property occupied by the borrower and in respect of loans granted for all other purposes, it is a report that is not more than three years old.
- ii. Directions on the Single Borrower Limit were amended to incorporate the following in respect of licensed commercial banks incorporated in Sri Lanka and licensed specialised banks;
 - (a) Funds realised from a new share issue or a rights issue may be considered as capital funds for the computation of the Single Borrower Limit effective from the date on which the proceeds of the share issue were received by the bank and accounted for in its books.
 - (b) A bank's current year's profits could be considered in the capital funds for the computation of the Single Borrower Limit to the extent that the External Auditors of the bank have certified such profits as being capitalised profits as at the date of certification.
 - (c) Further, if a bank incurs losses during the current year or if there is any reduction in the retained profits due to payment of dividends, *etc.*, capital funds considered for the computation of the Single Borrower Limit should be reduced accordingly to reflect the reduction.
- iii. Requirements relating to maintenance of Statutory Liquid Assets of off-shore banking units (OSBU) of licensed commercial banks were amended to provide for the maintenance of foreign currency liquidity for OSBUs liabilities and rupee liquidity for liabilities of domestic banking units, and for the expansion of the definition of liquid assets to accommodate specified instruments.
- iv. Guidelines on "Know Your Customer Rules (KYC)" relating to Certificates of Deposit (CDs) were introduced. Licensed commercial banks and licensed specialised banks were required to satisfy themselves with KYC in respect of customers who invest in CDs with banks, and of persons encashing CDs, issued on 30th June, 2003 and thereafter.
- v. Public Disclosure by Publication of Financial Statements in the Press. All LCBs and LSBs were informed that their financial statements should be published in the press on a quarterly basis within two months of the end of each quarter.

No. of years in "Loss" category	% of FSV of immovable property that can be counted as the value of security
1-2 years	60%
2-3 years	50%
3-4 years	40%

- vi. Display of Interest Rates and Exchange Rates. All LCBs and LSBs were requested to compile a representative list of their interest rates on deposits and advances and in the case of LCBs their buying and selling rates for foreign currencies as well, and to display such information to the general public in all branches and other banking outlets commencing from 1st January, 2004 the latest.

The Directions themselves appear elsewhere in this report.

Approvals for Banks, Branches and Other Banking Outlets and Consolidation in the Banking Sector

During the year 2002, consolidation in the banking sector through mergers and acquisitions, restructuring and closing and opening of branches and other banking business outlets took place.

- i. The Monetary Board granted a licence to the Housing Development Finance Corporation Bank of Sri Lanka (HDFC) to operate as a licensed specialised bank. The HDFC, which commenced operations as a building society in 1984, was converted to a public corporation in 2000 by the Housing Development Finance Corporation of Sri Lanka Act, No. 7 of 1997. In August 2003, the HDFC was licensed as a specialised bank with the objective of providing housing finance, in terms of Act, No. 15 of 2003.
- ii. The Department continued to process requests made by LCBs and LSBs for approval for the opening, closing and relocation of branches in terms of the Banking Act. During the year, approvals granted in this regard, included the following.
 - (a) With regard to branches, 54 new branches, closure of one branch, relocation of 52 branches and downgrading of 3 branches were approved. As a result, the total number of branches operating as at end of 2003 was 1,416 compared to 1,350 as at end 2002.
 - (b) Regarding other banking business outlets such as service counters, pawning centres, student savings units, extension offices and pay offices, 42 new outlets, one closure, 4 relocations and 10 up-gradings were approved. The total number of such banking outlets operating as at end of 2003 was 684 compared to 659 as at end of 2002.
 - (c) Meanwhile, approvals to establish 24 off-site Automated Teller Machines (ATMs) and one relocation were granted in addition to ATMs installed at the new branches. As at end of 2003, the number of ATMs in operation was 722 compared to 647 as at end of 2002.

Off-Site Surveillance System

Under the off-site surveillance system, the BSD continued to monitor the financial condition of LCBs and LSBs on the basis of periodic information provided by the banks on their operations. The periodic information mainly included weekly Interest Rates of Deposits and Advances, monthly returns on Selected Financial Information, Assets and Liabilities, Statutory Liquid Assets, quarterly returns on Income and Expenditure, Capital Adequacy, Non-performing Advances, Classified Advances and Provisioning for Bad and Doubtful Advances, Investments in Shares, Accommodation Granted to Bank Directors, their Close Relations and Concerns in which a Director has a Substantial Interest, Interest Spreads, half-yearly return on Share Ownership of the banks and annual Audited Financial Statements.

The information gathered is analysed to ascertain the risk exposure of individual banks and of the banking system as a whole. It also enables the comparison of the financial standing and performance of individual banks against their peers and against industry averages. Further, the information helps in identifying significant and critical changes in the financial condition of banks and serves as an early warning system to indicate vulnerabilities of particular banks or areas that require further investigation and examination. On the basis of early warning signals, banks are required to take prompt corrective action to rectify imprudent practices or excessive risk-taking which may lead to unsafe and unsound banking.

During the year 2003, the BSD continued to attend to work connected with implementation of the proposed new off-site surveillance system, initially designed on the basis of recommendations made by experts sponsored by the Swedish International Development Cooperation Agency (SIDA) in 2000. The proposed periodic returns to be submitted by the banks in place of current returns were reviewed by experts from the IMF and the Swedish Financial Supervisory Authority and finalised for implementation. To fully implement the new system, designing of output reports containing early warning signals and performance indicators of banks to be generated from the periodic returns was in progress. Initiatives were also taken to design and implement a central database for the Central Bank containing all the data reported by the banking industry to the Central Bank.

Statutory On-Site Examinations

In terms of the provisions of the Monetary Law Act, all licensed commercial banks are subject to statutory examinations, i.e. on-site examinations, at least once during each examination period as determined by the Monetary Board, which at present is two years, or if the necessity arises, at a lesser interval. On-site examinations on licensed specialised banks are conducted in terms of the provisions of the Banking Act.

The BSD has now fully adopted the new approach – the risk based examination process which focuses on identification of banking risks, the management of these risks and the assessment of adequacy of resources to mitigate these risks. In addition, a bank's compliance with statutory requirements, applicable laws and regulations, internal controls and the standards of corporate governance are assessed.

During the year under review, the BSD commenced examinations of 15 banks and completed the examination of 13 banks commenced in 2002. The reports of examination of 11 of the 13 banks were dispatched to the respective banks during 2003. The year 2003 saw the completion of 15 statutory examinations through an examination process which included interviews with management of banks, submission of Reports of Examination to the Monetary Board and dispatch of Reports to the respective banks. The examinations of 11 banks which commenced in 2003 await completion.

Bank Acquisition

In August 2003, the operations of MashreqBank psc, a LCB, in Sri Lanka were acquired by Union Bank Ltd. (incorporated in Pakistan). MashreqBank psc commenced its operations in Sri Lanka in April 1980 as a branch of Bank of Oman Ltd. incorporated in Dubai and its name was changed to MashreqBank psc in 1993. At the time of the acquisition, MashreqBank psc managed an assets portfolio of nearly Rs.1 bn representing 0.1% of total assets of commercial banks in Sri Lanka.

Bank Restructuring

Two LCBs *i.e.*, Union Bank of Colombo Ltd. (UBCL) and the National Mercantile Bank Ltd. (MERC) were successfully recapitalised and restructured with the assistance of two established large banks. This restructuring was carried out under the supervision of BSD and was facilitated by the necessary regulatory approvals of the Monetary Board.

- i.* The UBCL was recapitalised and restructured by a consortium of investors led by the Sampath Bank Ltd. (a LCB) in August 2003. Accordingly, the consortium infused, fresh equity capital of Rs.525 mn. subscribing to a different class of ordinary shares. Further, Rs.100 mn of capital in the form of debenture proceeds was infused, increasing the total new capital infusion to Rs.625 mn. The resolution of non-performing loans of the UBCL was accomplished through the establishment of a Special Purpose Vehicle Company (SPV) to which the non-performing loans were transferred. This recapitalisation and restructuring process successfully transformed the weak financial position of the UBCL by restoring the capital adequacy ratio to over the statutory minimum requirement of 10% and reducing non- performing loans considerably.

- ii.* The MERC Bank was recapitalised and restructured by the DFCC Bank (a LSB) by the acquisition of a 94% stake of MERC Bank to make it a subsidiary of the DFCC Bank. Consequent to the recapitalisation, the capital position of the MERC Bank rose to a level adequate to restore its capital adequacy ratio to over the statutory minimum requirement of 10 per cent. The Board of Directors of MERC Bank was also reconstituted to allow for adequate representation from the DFCC Bank. Later, the corporate name of MERC Bank was changed to DFCC Vardhana Bank Ltd. Its operations which were carried out through 3 branches at the time of restructuring were expanded with 4 more branches established at the premises of 4 branches of the DFCC Bank.

Resolution of Pramuka Savings & Development Bank Ltd. (PSDB)

Following from the suspension of the business of PSDB in October 2002, the Monetary Board decided to cancel the banking license of the PSDB and to issue an order in terms of the provisions of the Monetary Law Act to the Director of Bank Supervision to take action to wind up the PSDB. This decision was conveyed to the PSDB on 18 December, 2002.

Subsequently, 5 Court cases by groups of depositors and the management of the PSDB were filed in the Court of Appeal challenging the decision of the Monetary Board to have the bank liquidated and the licence cancelled. The Court of Appeal issued a writ of certiorari to quash the decision of the Monetary Board. The Court further issued a mandate in the nature of a Writ of Mandamus on the Monetary Board to consider options to resume the business of the PSDB.

On 3 July 2003, the Central Bank filed an application in the Supreme Court for special leave to appeal against the judgment of the Court of Appeal. However, on a suggestion in the Supreme Court, the Central Bank agreed to consider further the options for resuming the business of the PSDB.

In order to give effect to the agreement in the Supreme Court, the Monetary Board suspended the business of the PSDB again with effect from 22 July 2003. Thereafter, the Central Bank considered the options for resumption of the business of the PSDB during the remaining part of the year 2003 as highlighted below:

On 13 August 2003, the Central Bank published a press notice in Sinhala, English and Tamil requesting proposals from interested parties for the rehabilitation of the PSDB. Initially, six parties expressed interest, but finally the Central Bank received concept papers/proposals from the following:

- (a) Management of the PSDB.
- (b) Pramuka Bank Restructuring Committee.
- (c) A consortium of investors led by Asia Capital Ltd. (Asia Capital).

The Central Bank had discussions with the parties who furnished proposals/concept papers. Having given due consideration to the above concept papers/proposals and the recommendations of Messrs. Ernst and Young who were appointed as the Central Bank Consultants for this purpose, the Monetary Board decided that the only proposal that merits further consideration was the one made by the consortium led by M/s. Asia Capital. It was noted, in particular, that this was the only proposal where a firm commitment was made to infuse capital upfront to PSDB, which was considered as crucial, if the PSDB is to be rehabilitated.

With regard to Asia Capital's proposal, the Monetary Board was of the opinion that despite certain concerns, and the fact that the implementation of the proposal involves the fulfilment of several conditions precedent, the feasibility of the proposal could not be completely ruled out. Thus the Monetary Board decided to test its feasibility as against the only other option of liquidating the PSDB. In forming this opinion, the Monetary Board also took cognisance of the fact that even though, as currently estimated, the depositors may finally receive around 60% of the capital of deposits on a liquidation, there were other creditors such as those who have invested funds in money market bills of the PSDB who would not have qualified for any repayment in a liquidation, as they would not be treated as depositors in a liquidation.

Pending Asia Capital carrying out a due diligence to finally determine whether they would undertake the restructuring of the PSDB to enable it to continue to carry on business, the Monetary Board decided that the PSDB be permitted to resume limited business with effect from 22 January 2004, in terms of Section 30(3) of the Monetary Law Act, subject to specified conditions. A further decision on this matter is expected to be taken by 22 July 2004 after Asia Capital has completed the due diligence.

Administration of the Deposit Insurance Scheme

The BSD continued to administer the Deposit Insurance Scheme, which commenced operations in 1987. This is a voluntary deposit insurance scheme open to banking institutions licensed by the Central Bank and to co-operative societies registered under the Co-operative Societies Law, No.5 of 1972, which accept deposits. At present, only three Multi-Purpose Co-operative Societies have obtained insurance cover under the scheme in respect of deposit liabilities of their rural banks. The premium payable is 3.75 cents for every Rs.100 per quarter, and the amount paid to the Deposit Insurance Fund by way of premia in 2003 was Rs.1.3 million. The Fund stood at Rs.158.6 million as at 31 December 2003, which includes Rs.50 million allocated by the Central Bank in 1997. These funds have been invested in Treasury bills with a face value of Rs.167.3 million.

Meetings with Chief Executive Officers of Banks

The BSD continued to arrange monthly meetings, chaired by the Governor, with the Chief Executive Officers of LCBs and LSBs. These meetings served as a forum for exchange of views on issues and policies relating to banking operations and helped to build a close relationship between the banks and the Central Bank. Some of the major issues that were discussed at the meetings included strengthening of provisions for bad and doubtful debts of banks by applying progressive discounts on the value of property mortgages on loans, adherence to "Know your customer rules", publication of bank interest rates on deposits and advances and display of such information at branches and other banking outlets, the need for reduction of bank lending rates following the reduction of the policy rates represented by Repo rate and the Reverse Repo rate of the Central Bank on several occasions during the year, concerns over interest spreads of banks, implementation of the Financial Ombudsman Scheme, obtaining a credit rating to comply with a proposal in the budget for 2003 and application of prudential requirements on operations of OSBUs. The agreement of CEOs was obtained for restricting the payment of dividends and repatriation of profit if the prudential requirements in respect of OSBUs were not complied with. In addition, the CEOs were regularly apprised of economic and monetary developments in the country with a view to providing information useful for making more informed business decisions.

Financial Sector Reforms Committee

The BSD continued to have responsibility to service the Financial Sector Reforms Committee (FSRC) established by the Central Bank. The FSRC was initially set up in March 2002 as an internal committee of the Central Bank. The FSRC was reconstituted in May 2002 to make it more broad based. The FSRC has since been expanded to accommodate representatives of stakeholders in the financial system, both in the public and private sectors. Accordingly, the FSRC undertakes actions necessary to initiate, coordinate and implement financial sector reforms under the Regaining Sri Lanka Programme.

The FSRC chaired by the Governor consists of 20 members inclusive of 10 members from the Central Bank. In addition, other Heads of Departments/officers of the Central Bank and representatives of relevant institutions who are involved in the financial reform process are also invited to meetings to express their opinions when the necessity arises. The committee meets once in 2 – 3 weeks and had convened a total of 32 meetings by the end of December 2003 and 17 of these meetings were held during the year 2003. The BSD arranges meetings, maintains minutes and monitors and follows up the progress of activities undertaken in terms of decisions of the FSRC.

Financial Stability Committee

The Financial Stability Committee (FSC) which was established in 2002 was reconstituted in November 2003 to better represent the departments of the Central Bank responsible for functions relating to the financial system of the country. Consequent to the Monetary Law (Amendment) Act, No. 32 of 2002 (certified on 17 December, 2002), financial system stability is one of the two objectives of the Central Bank. Therefore, the role of the FSC is directly related to facilitating the Central Bank in the discharge of its responsibilities and objectives. Accordingly, the terms of reference of the FSC was decided as (i) Preparation of a Financial Stability Report (FSR) in the first year, and thereafter half-yearly. The first report is to be completed by the end of June, 2004. (ii) Assessing the risks and vulnerabilities leading to major financial system instabilities in the country (iii) Monitoring financial system stability and (iv) submitting periodic reports to the Governor and the Monetary Board, recommending policies necessary to promote financial system stability. The FSC appointed a group consisting of 12 members drawn from the relevant departments to conduct appropriate research studies, prepare financial stability reports, make necessary recommendations and function as the Committee's Think Tank. As at the end of 2003, the outline for the first FSR was finalised which was confined to an analysis primarily on the sectors covered by institutions which are regulated and supervised by the Central Bank on grounds that these sectors contain all systemically important institutions. Considerable progress was made in gathering necessary information for the FSR. It was decided to set up a dedicated financial stability unit in the BSD. Also, technical assistance by way of services of consultants from the IMF and Sveriges Riksbank (Central Bank of Sweden) were awaited to fully implement the financial stability framework in Sri Lanka.

Public Awareness of Financial Institutions

In 2003, the BSD issued the following press notices with a view to increasing public awareness about interest rates and service fees/charges of banks licensed by the Central Bank and the institutions that are legally permitted to accept deposits from the public.

- i. Publication of a one page paper advertisement on "*A Guide to Interest Rates and Fees of Banks*" in all major newspapers during the period 18 to 31 May 2003. In this publication, the bank-wise information of lending rates and deposit rates as at 28 April 2003 and levels of fees and charges of the commercial banking sector as at end of March, 2003 were published. The general public was further informed of the spread between lending rates and deposit rates prevailing in the country, advising them to negotiate with banks for better rates in a market environment.

- ii. Publication of a half-page press notice titled "*Institutions Legally Permitted to Accept Deposits from the Public*" in all major newspapers during the period from 17 to 22 December 2003. This publication was intended to assist the general public to be vigilant in order to ensure the safety of their deposits. While it contains a list of names of banks and finance companies licensed by the Central Bank to accept deposits from the public, it did not constitute a recommendation to the public to deposit in any one of the named institutions. The public was also informed to make its own choice with regard to making investments. However, the publication contained guidelines that would assist the public in making a choice.

The above-mentioned publications are available on the Central Bank's website.

Institutional Development in the BSD in 2003

During the year 2003, the BSD received considerable resources for the strengthening of its operations through services of consultants, training facilities, etc. As at end of 2003, the total staff strength was 65 when compared to 61 as at end of 2002. In June, 2003, the services of a resident Bank Supervision Consultant were obtained initially for a period of 18 months under the Central Bank Strengthening project funded by the World Bank. The Consultant is primarily involved in upgrading the on-site examination methodology with a risk-focus and providing training to examination staff. The IMF also provided the services of two consultants on three occasions for durations of 3-6 weeks each to advise on improving of the internal processes of the BSD. Meanwhile, the services of two officials from the Financial Services Authority of Sweden were received for one week under the SIDA Swedish Staff Exchange Programme to provide training to the staff. In addition, the services of a former Director of Bank Supervision were hired for a period of one year commencing October 2003 mainly to provide training to 17 new staff members posted to the BSD in 2003.

Currency Issue

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 2003. The volume of currency notes and coins in circulation by the end of 2003 stood at Rs.98,785 million, as against Rs.88,308 million at the end of 2002. This has been the highest ever recorded currency in circulation in the country. The continued high demand for currency was due to enhanced transactions following the peace process. Notes in circulation comprised 96.5 per cent of the total currency in circulation. The quantity of coins issued to

commercial banks during the year amounted to 103.4 million pieces with a total value of Rs.264.4 million compared to previous year's 76.7 million pieces at a total value of Rs.251.6 million. The quantity and value of coins issued to commercial banks during the period 2000 - 2003 are given in Table II - 1.

The Central Bank issued two commemorative circulation coins in the denomination of Rupees five to commemorate the 250th anniversary of the Syamopali Maha Nikaya in Sri Lanka in July 2003. Upon the requests made by the Malwatte and Asgiriya Chapters, the obverse of the coins were minted to depict the portraits of Weliwita Sri Saranankara Sangharaja Mahimi and Pravara Upali Nahimi of Siam (Thailand) respectively. Both coins were minted in nickel brass and was the exact size and weight as the existing five rupee coin.

Taking into consideration the attempts at counterfeiting currency notes, an enhanced security feature was introduced, in March 2003, namely a star wide security thread with a width of 3 mm and 4 mm into Rs.500 and Rs.1,000 currency notes respectively. The Department also continued to work in close cooperation with the Counterfeit Currency Bureau of the Criminal Investigation Department to contain and minimise counterfeiting attempts. The number of counterfeit notes detected in the country and referred for certification to the

Central Bank as required by the Monetary Law Act marginally declined from 1.8 notes per million notes in circulation in 2002 to 1.75 notes per million notes in circulation in 2003. During the year the two currency verification counting and sorting machines processed 135.9 million serviceable and unserviceable notes.

The Department continued to sell commemorative notes and coins to numismatists and collectors. Details of all commemorative notes and coins available for sale at the Central Bank together with their selling prices are given in Table II-2. Under the coin collecting program 10.0 million coins with a face value of Rs.53.0 million were collected by the department from places of religious worship etc. during 2003.

The Currency Department continued to conduct awareness programs on the identification of counterfeit notes and on the clean note policy for bank officers, school children, government employees and the general public, through public lectures and the electronic media. Given the shortage of new notes in some parts of the country, the Central Bank requested banks to collect unserviceable notes and send them for destruction and to recirculate new notes through their outstation branches.

The Department also participated in the following exhibitions organised by the Ministry of Industries.

TABLE II – 1
Quantity and Value of Coins Issued to Commercial Banks, 2000 – 2003

Year	Quantity (No. of coins, in thousands)										Total Value (Rs. '000)
	Rs. 10	Rs. 5	Rs. 2	Re. 1	cts. 50	cts. 25	cts. 10	cts. 5	cts. 2	ct. 1	
2000	10,693	15,413	16,186	4,876	6,936	4,320	1,955	1,287	75	430	62,171 226,057
2001	6,136	20,726	22,668	19,328	4,286	5,996	2,380	399	60	205	82,184 233,557
2002	10,965	16,820	19,968	11,991	8,466	5,752	1,770	396	185	425	76,738 251,553
2003	5,735	23,512	27,187	29,160	8,276	5,964	2,905	294	195	220	103,448 264,384

Source : Central Bank of Sri Lanka

TABLE II – 2
Commemorative Coins and Notes Available for Sale

No.	Description	Year of Issue	Face Value (Rs.)	Metal / Material	Selling Price (Rs.)
1.	40th Anniversary of CBSL (Presentation Box)	1990	500	Silver	600
2.	5th South Asian Games – Colombo (Pr. Box)	1991	500	12Kt. Gold	600
3.	5th South Asian Games – Colombo (Pr. Box)	1991	100	Silver	200
4.	3rd Anniversary of the Induction of President Ranasinghe Premadasa (Capsule)	1992	1	Cu / Ni	250
5.	2300 Mihindu Jayanthi (Pr. Box)	1993	500	Silver	700
6.	2300 Mihindu Jayanthi (Capsule)	1993	500	Silver	500
7.	50th Anniversary of the UNO (Capsule)	1995	5	Nickel / Brass	200
8.	50th Anniversary of Independence Sri Lanka (Pr. Box)	1998	5,000	22Kt. Gold	8,000
9.	50th Anniversary of Independence Sri Lanka (Pr. Box)	1998	1,000	Silver	1,200
10.	50th Anniversary of Independence Sri Lanka (Note Folder)	1998	200	Polymer	400
11.	Cricket World Cup - 1996 (Pr.Box)	1999	1,000	Silver	1,200
12.	50th Anniversary of Sri Lanka Army - Proof (Pr. Box)	1999	1	Ni Plated Steel	400
13.	50th Anniversary of Sri Lanka Army - Brilliant Uncirculated (Pr. Box)	1999	1	Ni Plated Steel	150
14.	50th Anniversary of CBSL (Pr. Box)	2000	1,000	Silver	1,200
15.	50th Anniversary of Sri Lanka Navy - Proof (Pr. Box)	2000	1	Cu / Ni	500
16.	50th Anniversary of Sri Lanka Navy - Brilliant Uncirculated (Pr. Box)	2000	1	Ni Plated Steel	200
17.	250th Anniversary of Syamopali Maha Nikaya (Folder)	2003	5x10 (coins)	Nickel / Brass	100

1. "Diri Gamana" exhibition held in Embilipitiya from 4 to 6 July, 2003.
2. "Yuga Dekma" exhibition held in Matara from 5 to 11 September, 2003.
3. "Nava Dekma" exhibition held in Colombo from 12 to 22 December, 2003.

The Central Bank stall at all these exhibitions was well patronised by school children and members of the public. More than 4,100 students and members of the public visited the Bank's Currency Museum during the year.

Domestic Operations

The Domestic Operations Department continued to perform its dual function of implementing the Bank's monetary policy, mainly through Open Market Operations (OMO) and enforcement of Statutory Reserve Requirements (SRR), and of serving as the banker to commercial banks and the government. In addition, the Department assumed the new responsibility of providing an intra day liquidity facility (ILF) to commercial banks and primary dealers to ensure a smooth operation of the Real Time Gross Settlement System (RTGS) introduced in September, 2003. During the year, a system of active OMO was introduced to enhance the effectiveness and market orientation of monetary policy operations, while the settlement of transactions on a real time gross basis within an automated general ledger system was introduced for banking operations of the Department.

1. Implementation of Monetary Policy

(i) Open Market Operations

A new system of OMO (*see Box Article No. 20 of the Central Bank Annual Report 2002*), which enables the Central Bank to actively manage market liquidity to achieve its monetary policy targets was introduced on 03 March 2003. The initial experiences and challenges under this system of active OMO are presented in Box 4 of this Annual Report. Under this system, OMO included several operations: (a) conducting daily auctions either for repurchase (Repo) transactions to absorb excess liquidity, or reverse repurchase (reverse Repo) transactions to inject liquidity, if there were a shortage of liquidity, on a daily basis (b) provision of Repo and Reverse Repo facilities under standing facilities and (c) outright sales of Treasury bills or purchases of both Treasury bills (in the primary or secondary markets) and Treasury bonds (in the secondary market only), at the discretion of the Central Bank, to absorb or inject liquidity on a long-term basis. As in the past, only Treasury bills were used as collateral for repo transactions, while both Treasury bills and bonds were used for reverse repo transactions. All commercial banks and primary dealers continued to be participating institutions (PIs) eligible to participate in transactions under the OMO of the Central Bank.

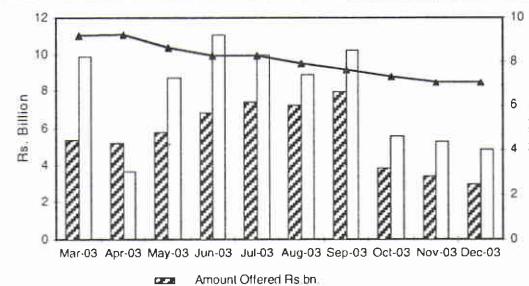
In 2003, the market operated with a rupee liquidity surplus mainly due to the purchase of foreign exchange in the market by the Central Bank and the net receipt of foreign loans by the government. While a part of the excess liquidity was absorbed on a long term basis through the operations of the Central Bank in the Treasury bill market on an outright basis and an issue of Central Bank Securities, the balance was absorbed on a daily basis through overnight repo transactions.

a. Repurchase (Repo) Transactions

(i) Under the Auctions System

Except for one day on which the market liquidity was in balance, auctions for repurchase transactions were conducted on every working day to absorb excess liquidity. The daily average repurchase auction value offered to the market was Rs.5.5 billion. The auctions were generally fully or over-subscribed, with the value of bids received amounting to Rs.8.0 billion per day, on average. The auction was under-subscribed only on ten days (5 per cent of auctions). As the amount offered to the market at the auction was on average about Rs.3.7 billion less than the estimated liquidity surplus, the average yield rate at the auctions remained close to the Central Bank Repo rate.

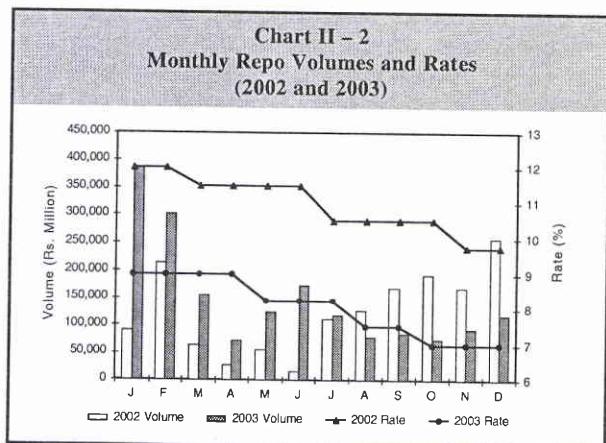
Chart II – 1
Amount Offered Bids Received and Average Yield
(Monthly Averages of the Repo Auction)



(ii) Under the Standing Facility System

The PIs which were not successful or did not participate in auctions invested their excess funds in Repos under the standing facility system. In addition, internally managed funds of the Central Bank too invested their excess funds under the standing facility. While the maturity period of repo agreements with PI was one day, internal funds were allowed to invest in up to a maximum of seven day repos. Since the introduction of the present system, on average repo facilities of Rs.3.6 billion per day under the standing facility have been utilised by PIs, while the amount

utilised by internally managed funds was Rs.2.8 billion (overnight equivalent per day). Repurchase transactions under the standing facility were at the Repurchase rate of the Central Bank.



(iii) Total Volume

The total value of repurchase transactions, both under the auction system and the standing facilities, inclusive of investments by internally managed funds, more than doubled from Rs.1,764 billion in 2002 to Rs.4,331 billion (overnight equivalent) in 2003, reflecting the continued excess liquidity in the market. The majority of these transactions (78 per cent) was with PIs.

(b) Reverse Repurchase (Reverse Repo) Transactions

As the market was liquid in 2003, there was no need for the Central Bank to inject liquidity on a daily basis through auctions. However, on a few occasions, reverse repo facilities under standing facilities were utilised by a very few banks in April and May, as they were unable to cover their entire requirements in the inter bank market due to internal limits imposed by banks on lending to other banks. The total value of government securities purchased under reverse repurchase agreements in 2003 was Rs.11 billion, only 5 per cent of the amount purchased in 2002. The main factor which contributed to this development was the action taken by the Central Bank to ensure adequate liquidity in the market during the festive seasons during which the market usually became short of liquidity due to heavy seasonal demand for currency.

(c) Outright Transactions in Government Securities

With the introduction of the present system of OMO, the facility for discounting and re-discounting at the secondary window of the Central Bank was replaced by outright sales and purchases of Treasury bills at the discretion of the Central Bank to manage liquidity on a longer-term basis.

During 2003, four weekly auctions were conducted to sell Treasury bills out of Central Bank holdings on an outright basis. Treasury bills to a face value of Rs.1 billion were offered at each auction. However, except the first, the other auctions were under subscribed as there was a preference for market participants to invest their excess funds on an overnight basis. The total value of Treasury bills sold through these auctions was Rs.1.7 billion. The weighted average yield rates at these auctions were in the range of 7.61 per cent to 8.08 per cent and were close to the comparable primary market Treasury bill yield rates. In addition, Treasury bills to a face value of Rs.0.7 billion were sold through direct dealing at prevailing market yield rates.

As the market was liquid, the Central Bank did not purchase any government securities in the secondary market. However, in order to ensure adequate liquidity, particularly during the festive seasons, Treasury bills were purchased by the Central Bank in the primary market. Total such purchases of Treasury bills in the primary market in 2003 amounted to Rs.49 billion, while Treasury bills to a face value of Rs.67 billion matured during the year.

(d) Issue of Central Bank Securities

As there was a risk that the Central Bank holdings of Treasury bills might not be sufficient to absorb the excess liquidity, which continued to expand, Central Bank Securities to a face value of Rs.5.1 billion was issued in September, 2003. These securities were issued without a coupon rate, on a discount basis, at rates comparable with the prevailing primary market yield rates for Treasury bills. The details of these issues are given below:

Central Bank Securities

Date of Issue	Maturity Date	Days to Maturity	Face Value (Rs.bn.)	Book Value (Rs.bn.)	Yield Rate (Net of Tax) %
23-Sep-03	23-Dec-03	91	1.020	0.999	7.50
24-Sep-03	24-Dec-03	91	1.528	1.497	7.50
29-Sep-03	29-Nov-03	60	2.024	1.997	7.34
30-Sep-03	30-Dec-03	91	0.509	0.499	7.26

(e) Statutory Reserve Requirement (SRR)

The SRR against deposit liabilities of commercial banks, denominated in Sri Lanka rupees, remained at 10 per cent during the year.

With effect from 03 April 2003, the basis of computing SRR was changed from deposit liabilities and vault cash balances at close of business on the preceding Wednesday of the reserve week, to the daily average balances of deposit liabilities and vault cash during the week ending the preceding Tuesday of the reserve week. This change was introduced mainly to improve the effectiveness of SRR.

(f) Bank Rate

The Central Bank's rate of interest (Bank Rate) on short term advances to licensed commercial banks, stipulated under Section 87 of the Monetary Law Act, was reduced from 18 per cent to 15 per cent per annum with effect from 15 August 2003 to be in line with the general decline in the Bank's own policy rates, *viz*; Repo rate and the Reverse Repo Rate.

2. Functions as the Banker to Commercial Banks and Government

(i) Financial Institutions Accounts

Operating as the banker to banks, the Central Bank continued to provide current account facilities to commercial banks and primary dealers to ensure an efficient inter bank payment and settlement system. With effect from 8 September 2003, these accounts were operated on a Real Time Gross Settlement basis within the automated general ledger system of the Bank.

(ii) Government Accounts

As banker to the government, the Central Bank continued to maintain accounts of government departments, government agencies and institutions and certain statutory boards, providing them with required banking facilities. The total number of such accounts maintained by the bank stood at 121 as at end 2003. Four new accounts were opened in 2003, while two accounts were closed at the request of the government. In terms of Section 89 of the Monetary Law Act, the Bank continued to provide provisional advances to the government. The limit on such advances (10 per cent of the estimated government revenue) was increased by Rs.1,600 million to Rs.32,972 million in 2003. There was no interest charged on these advances.

(iii) Import Duty Rebate to Exporters

The Bank reimbursed on behalf of the government, a total sum of Rs.65 million to commercial banks in 2003 in respect of import duty rebates paid by them to exporters as against a total sum of Rs.304 million reimbursed in 2002. This service was transferred to the Bank of Ceylon on the instructions of Sri Lanka Customs, with effect from 15 March 2003.

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

The total subsidy payments made on behalf of the government to repatriated estate workers of Indian origin under the Indo Ceylon Agreement of 1964 amounted to Rs.61,901 in 2003 against Rs.42,250 in 2002. Ex-gratia payments amounted to Rs.3,300 in 2003, as in 2002.

3. Provision of Intra Day Liquidity Facility

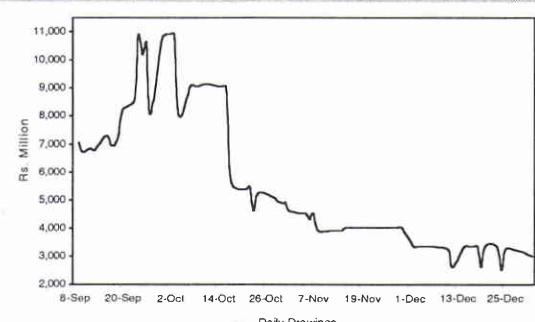
The Department assumed the responsibility of providing intra day liquidity to commercial banks and primary dealers, which

is essential for smooth and efficient operations of the RTGS system established in Sri Lanka on 8 September 2003. The intra day liquidity facility (ILF) prevents payments being held up unnecessarily in queues without being settled on a real time basis, thereby making the payment system more efficient. Funds under ILF are provided free of interest by way of intra day reverse repurchase transactions secured by eligible securities (government Treasury bills and bonds). Measures have been in place to ensure the security of funds released under ILF and their return to the Central Bank before the end of the same business day. Eligible securities are valued at their current market prices adjusted by a sufficient 'hair cut' to cover possible variations in price during the day. In case a PI fails to settle in full the funds obtained under ILF before the end of day, it is charged a default interest for the entire amount on the first occasion at the Bank Rate and on each succeeding occasion of default during a calendar year, such default interest will be increased by 100 basis points. If such default occurs more than once in one month, the Central Bank has the right to retain the securities against which ILF was granted and charge the default interest.

At the initial stage, drawings under the ILF by banks and primary dealers were relatively high, on average around Rs.8.4 billion per day in September, as the system was new and some participants obtained a relatively large amount as a precautionary measure. Gradually, with experience, participants reduced their ILF drawings to an average of Rs.3.2 billion per day in December. The actual utilisation of ILF was even lower, around 35 per cent (Rs.1.11 billion) of drawings on average in December 2003. The balance remained unutilised in the participant's RTGS Settlement Account at the Central Bank. As banks are allowed to utilise their balances under SRR for intra day settlement purposes, most banks managed to operate without ILF. There was only one occasion of an ILF default by a participant, but the penalty imposed promptly discarded it from repeating the same.

ILF which is repayable during the day, (day light advance), is considered neutral on the reserve money, and hence on the monetary policy stance.

Chart II – 3
Daily Drawings under Intraday Liquidity Facility – 2003



Employees' Provident Fund

The Employees' Provident Fund (EPF) marked another year of achievement in 2003. Superannuation Reforms, which are a component of the Financial Sector Reforms agenda, progressed further towards its target of reinforcing old age security through a sustainable market oriented mechanism. Reforming the superannuation system and developing the financial markets are interdependent and should go together for the efficient functioning and sustainability of both segments. EPF, being the largest superannuation scheme and the largest institutional investor in Sri Lanka, was the focus of attention on the reform agenda.

The Monetary Board, as the custodian of EPF, continued to discharge its responsibilities, in terms of the EPF Act, of receiving contributions, surcharges and income from investments, maintaining proper accounts of registered employments, members and the Fund, investing in suitable investments, and paying benefits to the members of the Fund with the co-operation of the EPF Division of the Department of Labour.

System Modifications

System modifications introduced during 2003 enabled the Fund to improve its efficiency, cost effectiveness and accuracy. Several modifications were done to the C3 collection system in order to update regularly the database with new and existing employer and employee details. The PC system that had been used to handle the receipt of contributions electronically was upgraded to the Fund's main AS/400 system during 2003. The provision of online auditing facilities to various audit units improved the audit procedures. A module for entering cheque receipts at the collections counter was designed during the second half of 2003. Cheque imaging was used to keep track of refunds made during the period 1992 to 1997, thereby avoiding any possible fraudulent reclaiming of EPF balances.

Participation of EPF in RTGS

EPF was granted authorisation to open a settlement account with the Central Bank to participate in the Real Time Gross Settlement System (RTGS) exclusively for investing and secondary market trading in government securities, and also to use a SWIFT workstation for transmission of messages related to transactions of the system. As a result, EPF commenced operations on RTGS in the fourth quarter of 2003 and was able to cover inter bank payments involving large values and settlement of government securities.

Public Awareness

Having appreciated the need for a comprehensive public awareness programme in order to bring the Fund closer to all its stakeholders, several steps were initiated during the year. An important measure in this respect was the establishment of

a Help Desk in May 2003, in order to respond quickly to issues raised by members. Member can raise queries at the Help Desk via telephone, e-mail and fax and prompt replies are ensured. Further, EPF actively participated in the 'Yuga Dekma – 2003' industrial exhibition held in Embilipitiya and Matara to enhance public awareness. This helped to reach members in remote areas effectively and thereby gave them an opportunity to resolve their problems immediately. These awareness programmes focus on introducing to all stakeholders of the Fund, their rights and responsibilities pertaining to EPF, correct procedures to be followed, and the significance of EPF for the members' well-being after retirement.

The annual member statements for 2002 and the semi annual member statements for the first half of 2003 were issued to members through their employers during the year.

Strengthening of Fund Management Capacities

A two-year comprehensive training programme in fund management was instituted in November 2003. Twenty young professionals were selected, after a rigorous selection process. The objective of this skills development is to strengthen EPF with competent fund management professionals in order to facilitate the ongoing restructuring activities in the fund management of EPF. The Sri Lanka Association of Investment Professionals (SLAIP), a member of the USA-based Association for Investment Management and Research (AIMR), which offers the world recognised Chartered Financial Analyst (CFA) charter for professional fund managers, is recognised as the facilitator and the trainer of this programme.

Management of Contributory Pension Fund for Public Servants

A Contributory Pension Fund (CPF) was established by the government to cover all the pensionable new recruits to the government and the local government services with effect from 1 January 2003. On a request made by the Ministry of Finance, the Monetary Board took over the custodianship and the management of CPF, while the Head of the Pensions Department has been charged with the responsibility for the system and process administration. The Monetary Board, during 2003, commenced discharging these functions, through EPF. A separate unit has been established in EPF to manage CPF. An affordable and appropriate computerised system is being acquired by EPF to ensure smooth operation of the CPF from its outset.

Housing Loan Facilities

An EPF member is eligible to obtain a loan for housing purposes from an approved lending institution, pledging the member's balance up to a maximum of 75 per cent of such balance. A second loan is also available upon the successful

settlement of the first. During 2003, EPF issued 18,689 member balance certifications for a total approved amount of Rs.2,791 million to lending institutions.

Investment Activities and Returns

During the year, the total investment portfolio of the Fund grew by 13.2 per cent, recording a cost value of Rs.320 billion at end 2003. Sustaining the last 5-year trend, the total investments in Treasury bonds – a long-term market oriented investment instrument, expanded in 2003. For the first time, it surpassed the total investments in Rupee securities – a long-term off-market instrument, in the total investment portfolio. This was in line with the EPF investment policy of diversifying its investments with market oriented instruments. Thus, the investment in Treasury bonds amounted to 56 per cent of the total investment portfolio as at end 2003, as against 36 per cent in 2002. Correspondingly, the share of investments in Rupee securities continued to drop further from 61 per cent in 2002 to 41 per cent at end 2003.

The period under review marked an improvement in the performance of the listed equity portfolio of EPF. The bullrun in the equity market, which was stimulated by new investor confidence generated by the peace initiative and conducive macro economic conditions in the country, moved stock prices to historically high levels during 2003. As a result, the listed equity portfolio of EPF (Table II-3) generated a total return of Rs.845 million or a rate of return of 69 per cent on its average portfolio in 2003. Active participation by EPF in secondary market trading of government securities in a downward moving general interest rate structure enabled EPF to realise substantial capital gains in 2003. The total capital gains of Rs.3,734 million realised by EPF from its secondary market activities contributed was the contributor to the increase in the realised rate of return on the total investment portfolio to 13.68 per cent in 2003 from 13.64 per cent in 2002. Although the overall general interest rate structure in the country moved downward in 2002 and 2003, the high yielding long-term investment portfolio of EPF, supported by high capital gains realised from listed equities and

TABLE II – 3
EPF : Performance of Equity Portfolio
during 2002 and 2003

Item	2002	2003	Rs. mn.
Average Portfolio	1,219	1,229	
Total Dividend Income (a)	90	97	
Total Capital Gains	143	605	
Bonus Shares Received (valued at the end of the period)	2	143	
Total Dividends, Capital Gains and Bonus Shares	235	845	

(a) Inclusive of tax-saving on tax-exempted dividends

Source : Employees' Provident Fund

TABLE II – 4
EPF : Secondary Market Activities
during the year 2003

Item	Volume Purchased (a)	Volume Sold (a)	Capital Gain	Rs. mn.
Treasury Bonds	15,525	21,795	1,474	
Treasury Bonds	33,165	33,567	3,124	
Treasury Bills	158	245	2	
Central Bank Securities	–	1,875	3	
Equity Shares	437	690	605	
Total	33,760	36,377	3,734	

(a) At cost values

Source : Employees' Provident Fund

government securities enabled EPF to declare an interest rate of about 12 per cent on its member balances for 2003.

Total Member Balance and Rate of Interest for 2003

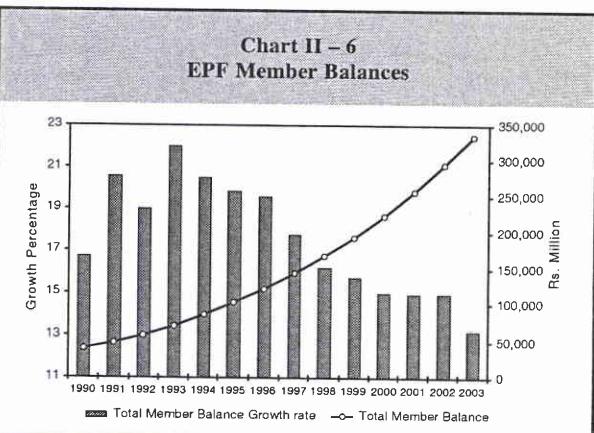
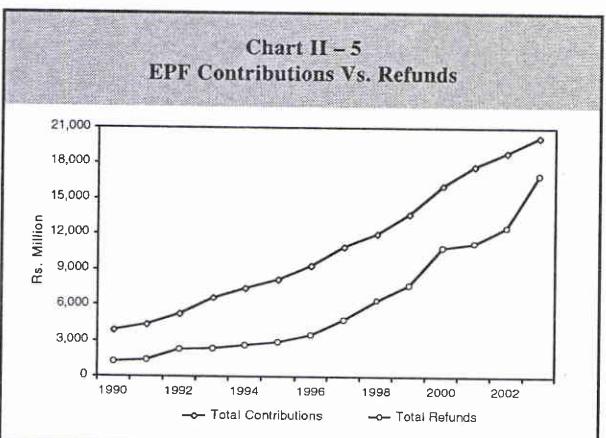
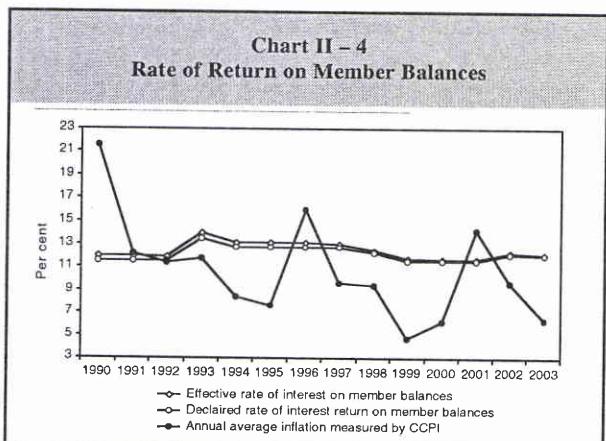
The total member balance of EPF grew by 13.2 per cent to Rs.334 billion at end 2003, after accounting for the declared rate of interest of 12 per cent in 2003. At this level of declared interest rate, the effective rate amounts to 12.07 per cent,

TABLE II – 5
EPF : The Salient Features

Item	2002	2003 (a)
Total Number of Members Accounts	9,378,384	9,725,000
Currently Contributing Members Accounts (CCMA)	1,860,122	1,997,000
Currently Non-contributing Members Accounts (CNMA)	7,518,262	7,728,000
Contributing employers	47,660	49,225
Total Contributions (Rs.mn.)	18,927	20,118
Total Refunds (Rs.mn.)	12,553	17,032
Number of Refunds	91,463	89,342
Total Investment Portfolio (Rs.bn.)	283	320
Government Securities Investments as a % of Total Investments (%)	97.5	98.3
Private Sector Investments as a % of Total Investments (%)	2.5	1.7
Realised Rate of Return on Average Portfolio (%)	13.64	13.68
Total Members Balance (Rs.bn.)	295	334
Total Gross Income (Rs.mn.)	36,171	41,313
Income Tax (Rs. mn.)	3,327	1,448
Administration Expenses (Rs.mn.)	333	299
Administration Expenses as a % of Gross Income (%)	0.9	0.7
No. of Member Balance Certifications Issued for Housing Loans	19,502	18,689
Annual Interest Rate Declared on Member Balances (%)	12.10	12.00
Effective Interest Rate Declared on Member Balances (%)	12.26	12.07

(a) Provisional

Source : Employees' Provident Fund



yielding a real effective rate of 5.77 per cent over the inflation of 6.3 per cent measured by CCPI.

Exchange Control

The year 2003, saw several major developments in the area of Exchange Control Reform. The most significant was the progress made to introduce new legislation titled the "Foreign Exchange Management Act" (FEMA) which provides for the

repeal of the existing Exchange Control Act. This is intended to transform the present regime of restricting and controlling foreign exchange to one of managing and regulating foreign exchange. The Bill for this legislation was published in the Government Gazette on 19/09/2003. It was subsequently listed in the Order Paper for presentation to Parliament on 19/11/2003. Thereafter, the Bill was challenged in the Supreme Court and the Court determined that certain amendments to the Bill are required to make it consistent with the Constitution. These amendments are being attended to by the Legal Draftsman.

During the year, measures to remove certain impediments on current account transactions and to further liberalise capital account transactions, announced in the Budget for 2003, were implemented. These measures included permitting the clearance by Sri Lanka Customs of all imports without referring to Exchange Control, easing of restrictions on rupee lending to foreign controlled companies approved under Section 17 of the BOI Act, enhancing the period permitted for forward purchases of foreign currency for the purpose of repayment of loans, permitting the import of goods on credit basis upto 360 days at a reasonable rate of interest and the forward purchase of foreign currency for imports from a bank other than the bank handling the import documents, permitting the conversion into foreign currency of rupee proceeds of sale of assets mortgaged for foreign currency loans on default of such loans, and easing restriction on the issue of guarantees to non residents. The repatriation out of Sri Lanka of sale proceeds of real assets purchased by non residents out of inward remittances of foreign currency brought into the country was also permitted. In addition, as a measure of extending the benefit of low interest rates on foreign currency loans to Sri Lankan workers employed abroad, banks were permitted to grant such workers foreign currency loans, to be released in rupees, to meet any requirement in Sri Lanka against the security of NRFC balances of such workers, subject to specified terms and conditions.

The Exchange Control Department also further streamlined its monitoring activities, with the multiple objectives of detecting transactions related to terrorism, in compliance with UN regulations, prevention of money laundering in terms of guidelines issued by the Financial Action Task Force (FATF) and prevention of exchange malpractices. Activities relating to the investigation into contraventions of the Exchange Control Act, registration of freight forwarders and granting and renewing of permits of travel agents, money changers and other persons and entities permitted to accept foreign currency also continued during the year. The supervision and monitoring of activities of money changers were also further strengthened during the year.

1. The Foreign Exchange Management Act

The repeal of the present Exchange Control Act and replacing it with new legislation titled "Foreign Exchange Management

Act" was recommended to the Government by the Financial Sector Reforms Committee (FSRC) with the approval of the Monetary Board, based on recommendations of a Task Force appointed by the FSRC to examine Exchange Control Regulations with a view to relaxing them in order to make transactions easier and smoother. Although, even at present, it is possible to further liberalise Capital Account Transactions by issuing directions and granting general permission under the provisions of the existing Exchange Control Act, the enactment of new legislation was recommended due to under-mentioned reasons:

- (i) To create confidence on the irreversibility and sustainability of liberalisation of current and capital transactions by making provisions in the legislation itself.
- (ii) The obsolete structure of the present Exchange Control Act in the context of recent developments in the financial sector and changes taking place in the foreign exchange regimes in neighbouring countries; exchange control/management laws in most countries are in terms of movement of foreign exchange in and out of the country on the basis of current and capital transactions, rather than in terms of specific transactions between residents and non residents.
- (iii) The criminal nature of violations of the provisions of the present Act which could attract severe penalties including mandatory imprisonment being an inhibiting factor for foreign investor activities and other business activities involving foreign exchange transactions, due to fear of attracting such penalties on the part of participants in investment and business activities.

The proposed FEMA, which was finalised by a Committee in the Ministry of Finance, seeks to remove the restrictive and prohibitive provisions of the existing Act and provide for the orderly management and regulation of outflows and inflows of foreign exchange in terms of current and capital transactions in a more liberal environment, rather than imposing rigid restrictions. This is expected to encourage the inflow of foreign capital for investment and create a more conducive environment for business activity. The proposed Act is expected to be enacted during the course of 2004.

2. Capital Transactions

(a) Non-Resident Investment in Sri Lanka

During the year 2003, no changes were effected with respect to Exchange Control regulations relating to investment in Sri Lanka by non residents.

(b) Investment Abroad by Sri Lankan Residents

During the year 2003, 12 approvals were granted by the Hon. Minister of Finance for investment abroad by resident companies and the total value of such investments was US dollars 29.2 mn. The areas in which such investments were

permitted included export promotion, financial services and travel services. In addition, two companies which were subsidiaries of foreign companies were permitted to participate in stock purchase plans of their parent companies.

(c) Rupee Lending to Non-resident Controlled Companies

In 2003, in terms of a Budget decision, to remove disparity between BOI companies fully exempted from exchange control and other foreign controlled companies, prudential limits that had hitherto been applicable relating to the quantum of rupee lending by banks to non resident controlled BOI companies were removed.

(d) Foreign Currency Borrowings by Residents

At present, authorised dealers are permitted to extend foreign currency loans to direct exporters and to specified indirect exporters. The NDB and DFCC are also permitted to extend foreign currency loans to exporters, provided that they have resources from foreign currency credit lines to do so. Hitherto, in the case of default of foreign currency loans secured by mortgage of domestic assets, authorised dealers were required to apply to the Controller of Exchange for permission to convert the rupee sale proceeds of such assets into foreign exchange. However, with effect from 21 January 2003, commercial banks were permitted to convert into foreign currency rupee proceeds realised from the sale of assets mortgaged in respect of defaulted foreign currency loans, without reference to Exchange Control Department, provided that the bank retains with them satisfactory evidence to the effect that a proper assessment was made of the credit risk when granting the loan and that efforts made to sell the mortgaged assets for foreign currency had failed. With effect from December 2003, as a measure of enhancing facilities available to Sri Lankans employed abroad, permission was granted to commercial banks to extend foreign currency loans to such workers for utilisation for any purpose in Sri Lanka, against the security of their Non Resident Foreign Currency Account (NRFC) balances, subject to certain terms and conditions, which included the requirement that the loan be released in rupees and the repayment be made in foreign currency. During the year, approval was granted to the DFCC Bank to participate in two syndicated loans to be granted to two BOI companies set up to generate electricity and for the Sri Lanka Insurance Corporation also to participate in the syndicated loan to one of them.

(e) Borrowing from Abroad by Resident Companies

Borrowing abroad by resident companies, other than companies approved under Section 17 of the BOI Act with full exemption from the provisions of the Exchange Control Act (Section 17 BOI companies), require the prior approval of the Exchange Control Department (ECD). During the year under review, two companies were permitted to borrow from abroad to a total extent of US dollars 4.08 mn.

(f) Forward contracts in Foreign Currency for settlement of loans

In terms of another budget decision implemented in 2003, the period for which forward contracts could be entered into for purchase of foreign currency from a bank for settlement of loans has been increased from 360 days to 720 days, subject to production of evidence regarding the commitment to repay the loan to the bank entering the selling contract.

(g) Issue of Bank Guarantees in favour of Non Residents

With the implementation of the decision contained in the Budget for 2003 for further liberalising the issue and renewal of guarantees on 21 January 2003, commercial banks are permitted to issue and renew guarantees in respect of obligations undertaken by residents in Sri Lanka which involve a payment in foreign exchange to non residents for the under mentioned purposes without reference to Exchange Control:

- (i) Bid Bonds in favour of non residents without a limit in respect of exports and service contracts, subject to conditions stipulated in the tender or quotation.
- (ii) Performance Bonds in favour of non residents without a limit in respect of exports or service contracts subject to proof of the award of the contract, and conditions stipulated in the contract.
- (iii) Letters of guarantee in favour of non residents for purposes other than those referred to in item (i) and (ii) above, upto a value of US dollars 500,000 subject to furnishing evidence of proof of the underlying transaction and other terms and conditions.
- (iv) Letters of guarantee favouring non residents to be issued at the request of agents resident in Sri Lanka on behalf of their foreign principals upto the value of US dollars 500,000, subject to obtaining a counter guarantee or counter indemnity on identical terms from the non resident principal in addition to other terms and conditions stipulated above in respect of letters of guarantee.

Prior to this liberalisation, the issue of bid bonds and performance bonds over 5 per cent and 10 per cent respectively of the value of a tender, and letters of guarantee in favour of non residents exceeding Rs.200,000, required the prior approval of the Controller of Exchange on a case by case basis.

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

Funds realised on the sale of capital assets belonging to Sri Lankan emigrants continued to be kept in blocked accounts, while the interest earned on such accounts were permitted to be remitted out after meeting tax liabilities, if any. As in the past, release of funds in such blocked accounts were permitted through commercial banks subject to a limit of Rs.750,000 per individual and Rs.1.0 mn. per family unit. Accordingly, during

the year, a sum of Rs.95.98 mn. had been remitted abroad in respect of 277 applications received from migrants leaving the country. Further, funds to the extent of Rs.23.24 mn. realised by the sale of immovable property belonging to Sri Lankan emigrants were remitted out during the year. The latter category also included cases where sale proceeds were claimed by non resident heirs of deceased owners.

(i) Repatriation of Sale Proceeds of Properties Owned by Non-Residents

The budget decision to permit persons to make payment of the purchase price of a residential property owned by a non-resident or his non-resident heirs, provided that the property had been initially purchased or developed by such non-resident out of inward remittances in foreign currency was implemented. Repatriation of such sale proceeds through authorised dealers upto the value of inward remittances brought in to purchase and/or develop the property was also permitted. However, any balance funds after the remittance of the permissible sum had to be kept in a blocked account in the name of the non-resident seller. This decision was implemented by the issue of a Notice under the Exchange Control Act published in the *Gazette* Notification No: 1312/9 of 28 October 2003.

3. Trade Transactions

In the area of international trade transactions, a major development was the amendment of the Regulations made under the Import and Export (Control) Act published in the *Gazette* No. 1022/6 of 8 April 1998 in respect of payment terms for imports. The amendment was effected by regulations made under the same Act published in the *Gazette* No. 1277/12 of 27 February 2003 empowering Sri Lanka Customs to release imports which do not fall within payment terms stipulated in the earlier regulations without referring to the Controller of Exchange. These included imports on "no foreign exchange involved basis" over US dollars 1,000 received as gifts, trade samples, and equipment and machinery sent by foreign investors for their projects in Sri Lanka. This was introduced as a measure of removing existing restrictions on current transactions. The maximum period granted for the import of goods on advance payment terms was also enhanced from 1 month to 3 months by a Regulation published in the *Gazette* No. 1319/28 of 18 December 2003. However, Exchange Control continues to monitor import of goods for which payment has been made in advance to ensure the arrival of goods. Two other budget decisions also aimed at providing further facilities for trade transactions were implemented with effect from 21 January 2003. One was to permit importers to purchase foreign currency on a forward contract from a bank other than the bank establishing documentary credits for imports and collecting import bills on documents against acceptance (D/A) terms or against Documents against payments (D/P) terms. Hitherto, such forward purchases were permitted

only from the bank handling the import documents. The other was to permit commercial banks to allow the import of goods on credit terms upto 360 days, provided that the interest charged is reasonable. Prior to implementation of the latter decision, the approval of the Controller of Exchange had to be obtained to pay interest on supplier's credit facilities.

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

ECD continued to register Freight Forwarders, grant Travel Agencies the authority to issue Travellers Cheques and issue/renew licenses of Money Changers and other establishments such as hotels, duty free shops, travel agents and service providers to accept foreign currency with respect to sales and services performed by them to tourists.

(a) Registration of Freight Forwarders

During the year 2003, 9 new companies were registered as freight forwarders, bringing the total number of companies registered as freight forwarders to 126 at the end of the year. The ECD continued to monitor the activities of registered Freight Forwarders.

(b) Authority for Travel Agents to issue Travellers' Cheques

During the year 2003, one more Travel Agent, N Car Travels and Tours Ltd., was granted authority to issue travellers' cheques bringing the total number of Travel Agents so authorised to 9.

(c) Appointment of Money Changers and their supervision

In 2003, the ECD issued permits to 3 companies to engage in the business of money changing, while the permits of 37 Money Changers were renewed, bringing the total number of authorised Money Changers to 40. As a result of requiring a minimum turnover of US dollars 5,000 per month and the regular inspections carried out on Money Changers, a growth in turnover of the Money Changing business has been recorded in the year 2003. The annual turnover of Money Changers increased from US dollars 155.0 mn in 2002 to US dollars 170.2 mn in 2003, representing an increase of 9.0 per cent over the previous year.

5. Monitoring

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

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

Monitoring activities on the sales and purchases of foreign exchange were pursued with greater intensity with emphasis being placed on detecting un-authorised capital transfers as well as remittances which may be associated with financing of terrorist activities or money laundering activities. During the year, ECD took steps to encourage banks to submit information on the sales and purchases of foreign currency electronically, using software developed by the Information Technology Department of the Central Bank which has now been installed in head offices of all commercial banks. At present, information in respect of sales of foreign exchange for travel exceeding US dollars 5,000 are submitted electronically by the head offices of banks. Once the submission of data electronically is expanded to cover branch offices, monitoring activities could be speeded up and used more effectively for early identification of trends in the inflow and outflow of foreign exchange, while the system would also serve as an effective early warning mechanism on the financial stability situation and any impending foreign exchange crises etc.

Although Anti Money Laundering legislation has not yet been passed in Sri Lanka, all commercial banks have been requested to follow the 40 recommendations of the Financial Action Task Force (FATF) for prevention of money laundering. Due to the diligence exercised by the ECD and the banks, attempts to use the banking system to commit financial frauds have been thwarted. Further, in one instance where the source of funds remitted to Sri Lanka in respect of an advanced payment was suspected to have originated from a financial fraud, steps were taken to prevent the persons involved from withdrawing such funds from the banking system.

During this year too, the ECD issued several Operating Instructions to commercial banks, specialised banks, money changers, travel agents authorised to issue Travellers' Cheques (TCs), and other persons and entities authorised to accept foreign currency, drawing their attention to the need to diligently comply with directions issued by the Ministry of Foreign Affairs in terms of UN Regulations No. 1 of 2001, and ECD's Operating Instructions in this regard, and also requesting information in respect of attempts made to open accounts or undertake transactions by persons or entities which bear any connection to the list of persons and entities designated as persons and entities to which the above regulations apply. In several instances where there was a suspicion that inward foreign exchange remittances were linked to such persons and entities, steps were taken to prevent the release of such funds

pending a thorough investigation of the source of the remittance.

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

6. Investigation

The ECD continued with investigations on alleged violations of the Exchange Control Act. Investigations into a total of 42 cases were concluded and penalties were imposed in respect of 6 cases, and a further 5 cases were identified for imposition of penalties. In addition, penalties were imposed in respect of another 3 cases where exchange control violations were detected and the parties admitted the violations. Total penalties imposed in respect of all these cases during the year was Rs.2.4 mn. A significant development in the area of investigations was the filing of indictments by the Attorney General's Department on investigations concluded by ECD against persons involved in a massive Exchange Control fraud. The total value of foreign exchange involved in the fraud is estimated at Rs.1,331 mn.

Representatives of the ECD participated in the Indo-Lanka Bilateral talks on Customs procedures and briefed the Indian Customs Authorities of the progress made in investigations related to cases of alternative remittance agent activities in Sri Lanka referred to the Central Bank by the Indian Customs Authorities.

Information

As the central information unit for the Bank, which is responsible for dissemination of information to Bank personnel as well as to the general public, the Information Department continued to perform its functions and duties and other special assignments during 2003.

'Kauluwa', the in-house news and the features magazine, which acts as a two way communication path between employees and the management was continued, releasing 11 issues on various themes specifically on the issues of Bank's Modernisation Programme. Among the topics covered were Human Resource Development, Performance Management Systems, automated payment systems *i.e.* Real Time Gross Settlement System and the Scripless Securities System. The newly introduced intranet web page was the new addition to the Department's information service base for internal communication. It provided the Bank staff with a vital link to a wide range of local and international financial news and other current economic information.

In order to address the issue of misleading and unethical advertisements appearing in the electronic and print media relating to financial sector, the Department proposed to the

members of the Accredited Advertising Agencies Association (4As), a draft code of best practices for media communication in the financial sector. The proposed code has been prepared by the Task Force on Public Awareness under the Financial Sector Reform Committee for voluntary adoption by media institutions.

The Department caters the public information needs in various ways. It published the daily exchange rates, weekly and monthly economic indicators, consumer price indices, information on Treasury bills and Treasury bonds. The Department also handled publicity work of the Bank's activities via releasing of 66 press releases, 07 *Gazette* notifications and publishing 141 advertisements in the newspapers. The Media Division organised 10 press conferences during the year on Monetary Policy and GDP Quarterly Data Review. A special luncheon meeting for the Heads of the media institutions was held to discuss important economic issues. It also handled the media coordination for public lecture series organised by the Centre for Banking Studies. The Department continued to publish the monthly publication 'Satahana' and 'News Survey' the bi-monthly publication. 'Kurippedu', the Tamil version of Satahana, which was launched in year 2002 for the benefit of Tamil readers, was published during this year as well. Several TV programmes were also organised by the Department under its publicity programme.

The Bank's Printing Press as in the previous years, continued to fulfill the printing requirements of the Bank. The regular printing assignments included the printing of Annual Report of the Central Bank, Sri Lanka Socio-Economic Data and Economic and Social Statistics of Sri Lanka, News Survey, Satahana, Kauluwa and Staff Studies. In addition, two special publications were also prepared on Real Time Gross Settlement System, Scripless Securities System. 'Kauluwa', the monthly internal news magazine of the Central Bank which had been printed mostly in black and white in previous years, was printed in four colours. All printing work with regard to the Consumer Finance Survey 2003/04, conducted by the Statistics Department were done during the year. The fourth revision of the Laws Relating to Banking and Finance in Sri Lanka was a special publication issued during the year. Along with these printing assignments, the Printing Press undertook 230 printing assignments including greeting cards and the Central Bank Diary. Six publications for the Ministry of Finance were also entrusted to the Printing Press during the year. The Department, continued to provide photographic and artistic design services to the Bank.

The Department was assigned to design an educational tele-drama to educate people on EPF. The preparation of the preliminary script had been completed and the documentary is earmarked to be produced during early 2004.

The Sales and Distribution Division handled the distribution work of the Department, through its sales outlets in the Bank and through a network of bookshops island-wide.

The Department actively took part in the 'Yuga Dekama' industrial exhibition at Matara and 'Nawa Dekma' exhibition at Colombo. Apart from these, publications were given on consignment basis to be sold at 'Sarasavi Mela' exhibition at the University of Colombo, 'Nawa Dekma' at Embilipitiya and an exhibition at the University of Colombo. As per the request made by some schools, arrangements were made by the Department, enabling them to visit Central Bank, including the Currency Museum.

Library and Information Centre (LIC)

The Library and Information Centre (LIC) increased its collection of Books from 11,274 to 14,562 , reports from 7,674 to 9,627, CDs from 800 to 843 and maps from 7 to 22, and added 210 bound volumes to the collection during the year. The Library at the Centre for Banking Studies too increased its collection from 4,296 to 4,637.

Further LIC subscribed to 240 journals with online access and to online services such as *Centralbanknet.com*, *Economist.com*, *FT.com*, *AWSJ.com*.

During the year under review LIC continued to compile electronic publications such as *Recent Additions (New books received by LIC)*, *Current Contents*, *Selected Articles*, *Central Banking Around the World*, *News Alert* and disseminated them to library users via intranet.

The services extended by LIC were improved by streamlining the book circulation through measures such as introduction of Library guide lines, registration of Library users, imposition of Library fines and completion of bar-coding of the entire book collection. As a result the book circulation increased distinctly from July onwards.

The membership of *Economics and Banking Library Network (ebanklibnetsl)*, which was initiated by LIC in 2002, has increased its membership from 17 to 23, institutions. LIC was the highest contributor to the network during the year.

Information Technology

The Central Bank, following the international best practices, took action to upgrade the national payment system to reduce any systemic risk and effect faster settlement of transactions among the major players in the financial market: commercial banks, primary dealers and selected institutional investors,. This involved the installation of 3 state of the art advanced systems, *viz*, a Real-Time Gross Settlement (RTGS) System, Scripless Securities Settlement System (SSSS) and an automated General Ledger System (GLS) for the Central Bank. The implementation of all 3 systems was assigned to the Information Technology Department (ITD). These are the key projects involving technological improvements under the Central Bank Modernisation Project funded by the World Bank.

The implementation of RTGS on 8 September 2003, and the installation of the SSSS to proceed for live implementation in February 2004, have made a substantial leap in the use of Information Technology (IT) in the national payments infrastructure, making Sri Lanka the first country in the region to operate a payment system equipped with the state of the art technology. ITD played a proactive role in critical areas of the project such as project management from planning to implementation stages, transferring the technical knowledge to commercial banks and primary dealers, preparation of the IT infrastructure, oversight of software testing for compliance of functionality with the business and technical requirements specified in the bid document and managing the migration process into the live environment. To further modernise the payment system, work is being initiated by the Central Bank to introduce Cheque Imaging and Truncation (CIT) to the country's cheque clearing system with the long term objective of moving towards an electronic cheque. ITD, which is expected to play a leading role in this project as well, provided technical inputs in conceptualising the CIT concept and the data communication methodology.

ITD continued its efforts in uplifting the IT infrastructure of the Central Bank as well as the IT knowledge. During the year a significant expansion of IT use in the Bank was achieved, due to implementation of several IT systems; RTGS, Integrated General Ledger, Treasury Dealing Room Management for international operations, computerised system to conduct active open market operations. These systems provide facilities for an on-line data entry, transaction processing in real time and convenient access to information. Currently, the day to day functions of the Central Bank are mostly IT enabled. Altogether, 700 networked personal computers are provided to the desktop of officers to discharge their functions in an IT enabled-environment, with an emphasis on taking decisions based on timely information and analysis.

The e-mail facility, which was earlier limited to all staff officers, was extended to cover non-staff officers as well. The Internet connections to the desktops of staff officers was expanded, to facilitate access to information to a wider group and to promote self-learning as part of human resources development. To accommodate the increased e-mail and Internet traffic, the leased line capacity providing internet/e-mail connectivity was expanded to 256 Kbps. The 'self-service' concept in accessing information by officers is adopted with the introduction of Central Bank Information Service where individual departments place information on websites accessible for internal staff only. A website for the Welfare Department was developed by ITD, which was implemented on 29 October 2003. Currently, departmental websites are active in Economic Research, Statistics, Information Technology, Training, Information and Welfare. These developments have led to a gradual displacement of the paper based working environment, which is considered as conducive for a modern Central Bank.

Software Development Projects

ITD continued to develop several AS/400 based as well as PC based applications for the user departments of the Bank. These projects were undertaken as a means of replacing most of the manual processes and as interfaces to RTGS System, SSS System and the automated GL System.

A project undertaken to computerise the functions of the Currency Department during the previous year continued in 2003, and the software development for all divisions of the Currency Department, namely, the Deposits, Main Vault, Issue Vault, Currency Counting and Verification Division have been completed. The testing of the software for compliance with user specification is in progress. The implementation of the in-house developed computerised system is expected to lead to further improvements in currency management function and to perform the functions of the Currency Department more effectively with a lower staff strength. The software for the currency counter will be developed after these modules are implemented, to complete the automation of the functionality of the department during the first quarter of 2004.

CBSL commenced active Open Market Operations (OMO) from February 2003, onwards as a step towards market orientation of monetary policy operations and to improve their effectiveness. The software to conduct the active OMO using the CBSLNET (Wide Area Network) infrastructure and to transfer and settle the securities/funds involved through the RTGS/SSSS was developed and implemented by ITD.

The Premises Department benefited from the software development effort of ITD as applications were implemented to monitor the stock movements in the engineering stores and an application for monitoring and control of the cost of transport services delivered to departments through the outsourced cab services, within the budgetary provisions for each department.

The practice adopted in developing software and related documentation were formalised making it mandatory to prepare and obtain sign-off with regard to User Requirement Specifications, Solution Design, documentation of test scripts and the test plan for accepting software for implementation.

Management of IT resources for EPF Department

ITD continued to maintain the EPF application system for the EPF Department. Further automation was undertaken during 2003. The EPF network was expanded. It currently accommodates 197 computer peripherals directly connected to the EPF system. ITD expanded the scope of the sales and purchases of Treasury bills sub-system to accommodate trading of Treasury bonds.

ITD was involved in the initial study of the Government Contributory Pension Scheme. A modularised application was developed to facilitate data capturing and accounting aspects. ITD is also represented at the EPF-ETF amalgamation steering

committee and has assisted by providing statistics and other required information to the committee. ITD also continued providing information to Labour Department and other related institutions on EPF matters. These facilities were provided by ITD in addition to the overall maintenance of the EPF computer installation.

Expansion of IT infrastructure

IT infrastructure had to be extensively expanded to facilitate the implementation of RTGS, SSSS and the automated GLS. It became necessary to install the SWIFT software at CBSL to enable the receipt of transaction related SWIFT messages sent by participant banks and primary dealers and to transmit them to RTGS/SSS system for processing. The SWIFT software operating platform which was earlier on Windows NT was migrated to the UNIX platform to be compatible with RTGS/SSSS operating platform. All participants were configured to a SWIFT Close User Group for the secure transmission of SWIFT messages to RTGS/SSS systems.

Some of the infrastructure development work completed prior to the implementation of RTGS/SSSS are as follows:

- i. Leased line connectivity from Head office to the backup site was upgraded to 2MBPS.
- ii. Completed laying of a backup fibre optic backbone at the head office.
- iii. Installation of fire protection equipment at the server rooms.
- iv. Increased the UPS capacities at the main site as well as the backup site.
- v. Expansion of floor capacity at the backup site to commence operations during a disaster.
- vi. Installation of an auditable access control facility at the backup site.

With the expansion of the computer network the need for IT resources increased considerably and it was evident that the availability of IT resources had to be maximised. A help desk was established in ITD to log all user problems. Several training sessions were held for departmental IT liaison officers so that they are equipped to handle most of the IT related issues in their own departments. With a view of increasing the IT awareness of Central Bank officers, staff of ITD was released to conduct lectures and training sessions at the Centre for Banking studies.

Implementation of RTGS / SSS systems

The RTGS and SSSS projects were undertaken by CBSL, to automate the payments and settlement system and the Securities Settlement System of Sri Lanka to achieve the following:

- Reduce settlement risk in the payment system and securities system in line with emerging best international practice

- Enhance the integrity and tradability of Public Debt
- Establish the regulatory framework to underpin the new operational mechanisms

The RTGS project was successfully implemented on the 8 of August, 2003. The implementation of the SSS system has been scheduled for the 2 of February, 2004. With the implementation of the SSSS, all government securities will reside in electronic form in a Central Depository at CBSL. The application software CAS/LCSS release 2.60 that was provided by Logica is running on IBM RS/6000 computer system with AIX 5.1 as the operating system and Informix as the relational database management system. To process the RTGS/SSSS transactions and the SWIFT messages, 2 servers are located at the primary site and another at the secondary site for backup purposes. The secondary site is connected on-line to the primary site and is updated on real time basis. The payment transactions are received by the RTGS system through SWIFT connectivity, which is considered as the safest and most secure communication system. All commercial banks and primary dealers are connected to the system through SWIFT connectivity to transmit transaction messages to the system and the CBSL Wide Area Network (WAN). The CBSL WAN is used by the banks to access their account balances, browse payments pending settlement, change priority of such payments and for downloading reports.

To facilitate this implementation, ITD had to develop several interface programs namely –

- To upload main and settlement clearing data from LankaClear to RTGS system.
- SLIPS (inter bank payments) data from LankaClear to RTGS system.
- On-line OMO system for auction bidding and other secondary market trading
- Facility to dematerialise securities in scrip form to scripless
- Facility to upload transactions using the matched trade feed option provide in the SSS system

Most of the above systems were implemented using the AS/400 resources and the CBSLNET.

Implementation of the Automated General Ledger System

ITD also played an active role in implementation of the GLS, which was implemented on the 8 of August 2003. This was undertaken to ease the financial and accounting operations of the bank and to facilitate the creation of a Management Information System (MIS) to provide timely information for decision making. The application software developed by DMS Ltd., has two modules; General Ledger and the Treasury Dealing Room Monitoring System (TDRMS). The two systems are implemented using HP9000 servers using UNIX as the

operating system. Oracle9 is used as the Database management system. 2 servers are located at the primary site for GL and TDRMS systems and another at the secondary site for recovery purposes. The secondary server is updated on-line on a real time basis. Two other HP servers are also located at the secondary site to be used for testing and training and development work. ITD had to develop several interface programs to connect up all staff payments within the bank to the GLS to accommodate the new formats of the GLS.

International Operations

(a) Report on Activities During 2003

The Central Bank is the custodian of the official international reserve of the country and is responsible for managing it. This function is carried out by the International Operations Department (IOD). The Monetary Law Act, No. 58 of 1949 specifies that CBSL should maintain an adequate international reserve in liquid currencies, and a nuclear reserve in gold among its assets in order to maintain the international stability of the Sri Lanka Rupee and to assure the greatest possible freedom of its current international transactions.

Safety, liquidity and return are the main considerations in reserve management by the Central Bank. IOD invests the official foreign exchange reserve in the international money and capital markets through approved counterparties and within limits authorised by the management, while maintaining an appropriate balance between liquidity and the rate of return on the Bank's assets. A major part of the international reserve is invested in fixed income securities and the balance in fixed deposits, call and current accounts and in gold. The Bank invests only in highly rated government or government guaranteed fixed income securities or in those of supra nationals'. Its investments in money market instruments are limited only to highly rated counterparties whose ratings are regularly reviewed by the Bank.

IOD reviews the economic fundamentals of major currencies, interest rates and exchange rates regularly and make required adjustments in the currency and asset composition of the reserves to preserve its value. The main currencies in which the reserves were held during 2003 were US dollars, sterling pounds and euros with appropriate changes to the composition depending on the strength of each currency. Debt service requirements and income generating capacity of the currencies and securities were also considered in determining the currency composition. The total net foreign income generated through the foreign exchange reserve management operations was US dollars 67.5 million or Rs.6.5 billion during 2003.

IOD continued to closely monitor the domestic foreign exchange market developments with a view to promoting the smooth functioning of the market and to ensure an orderly adjustment of the exchange rate. IOD's operations in the

domestic foreign exchange market contributed towards maintaining the exchange rate stability during 2003. The exchange rate remained almost unchanged at the end of December 2003 at Rs.96.90 per US dollar recording only a 0.01 per cent depreciation against the US dollar during the year compared to a depreciation of 3.7 per cent in 2002. IOD was able to maintain exchange rate stability particularly when the US dollar was depreciating against all currencies and rupee was appreciating amidst larger foreign exchange inflows. IOD was also able to build up the foreign exchange reserves of the country by buying US dollars 375 million from the market on a net basis, adding the largest single foreign exchange inflow into the reserves during 2003. (Table II-6).

The summary of CBSL's foreign exchange transactions in the domestic market in 2003 is given in Table II-6 and II-7. Inter-bank foreign exchange transactions are given in Table II-8.

The Middle Office of IOD monitors the risks associated with foreign exchange reserve management activities and submits reports to the management. The level of operations of this Division has been expanded during 2003 to cover risk management including risk assessment and monitoring,

TABLE II – 6
Monthly Summary of CBSL Foreign Exchange Transactions with Commercial Banks in Sri Lanka – 2003

Month	Purchases	Sales	(US \$ mn.)
January	38.8	–	
February	16.0	–	
March	18.0	–	
April	30.0	–	
May	10.0	–	
June	42.0	–	
July	46.2	–	
August	56.5	–	
September	76.5	–	
October	28.8	–	
November	–	2.5	
December	14.8	–	
Total	377.4	2.5	

TABLE II – 7
Annual Volume of (Cash, Tom, Spot) Purchases and Sales of Foreign Exchange by CBSL – 2003

Year	Purchases	Sales	Net	(US \$ mn.)
1996	96.2	198.0	-101.8	
1997	136.7	154.0	-17.3	
1998	61.0	214.8	-153.8	
1999	0.4	58.2	-57.8	
2000	2.0	303.6	-301.6	
2001	179.2	51.8	+127.4	
2002	223.7	46.6	+177.1	
2003	377.4	2.5	+374.9	

TABLE II – 8
Inter-Bank Foreign Exchange Transactions Volume – 2003

Month	Cash	Tom	Spot	Forward	Total	(US \$ mn.)
January	23.3	47.5	89.5	152.2	312.4	
February	28.2	40.9	63.0	97.3	229.3	
March	26.4	25.9	50.9	113.5	216.7	
April	40.8	35.8	60.8	124.5	261.8	
May	36.6	31.7	50.5	96.6	215.4	
June	23.3	49.6	71.4	133.1	277.4	
July	35.6	31.0	92.9	105.8	265.2	
August	30.4	36.7	99.1	141.6	307.7	
September	20.8	40.5	419.1	229.9	710.2	
October	20.0	29.1	211.7	128.1	388.8	
November	6.5	12.4	178.3	62.7	259.8	
December	14.3	20.7	115.7	51.9	202.5	
Total	305.9	401.6	1,502.7	1,436.9	3,647.0	

provision of information to the dealers in the Front Office and management for decision making, research on global financial markets, maintenance of core information (master) on reserve management, other regular evaluation of dealing room activities and dealer performance, conduct of research activities in financial modeling techniques, other decision enhancing tools, and a continuous evaluation of dealing relationships and counterparties of the Bank.

In the risk management process, the Bank adopts several different approaches based on the type of risk under consideration. Work relating to assessment of duration together with a mechanism for regular comparison with the actual portfolio was commenced during the year and a more precise duration benchmark is to be introduced in the near future. A detailed limit structure based on counterparty creditworthiness (assessed on a ratings based framework) is used to minimise credit risk exposures of the Bank. The Bank assesses the market risk based on a widely used statistical measure known as Value at Risk (VaR). Separate limits at portfolio level as well as at relevant sub component level have been established to facilitate the management of market risk.

Middle Office continuously assesses the different types of risks attached to the Bank's foreign reserve portfolio and compares with established benchmarks on real time basis. Impact of any deviations beyond the approved ranges is assessed on timely basis and brought to the notice of the management together with the suggested remedial measures. Risk measures are also being provided to the foreign exchange dealers to be used in support of their day-to-day investment decisions. With the introduction of the new Treasury Dealing Room Management System (TDRMS) dealer supervision, risk monitoring and transaction recording are done on real time basis, which also facilitates the timely display of risk measures and other decision support tools. Performance of the reserve management activities are evaluated and reported periodically to the Monetary Board together with any changes to the risk profile of the reserve portfolio. The Middle Office keeps track

on daily activities of the dealers/dealing room and compares activity and performance with pre-approved guidelines and limits. Any deviations beyond the approved range are reported to the management immediately.

(b) Major Administrative Measures Taken During 2003

The Foreign Reserve Management Committee (FRMC), a sub-committee charged with the function of management of foreign reserves, continued to set policy and the overall strategy, while reviewing the existing procedures, guidelines, responsibilities, portfolio setting and risk management. It also adopted the policies and procedures as required for efficient reserve management and risk management. Meanwhile, the Market Operations Committee (MOC), another sub-committee attending to day to day monetary and exchange rate policy met daily and continued to adopt daily investment and market intervention strategies. The Treasury Operations Committee which was set up in 2003, discussed the operational issues with regard to dealing, settlement and book keeping as and when they arose.

CBSL decided to reclassify its fixed income securities portfolio into available-for-sale (AFS) and trading (TRD) categories in line with best international practices in 2003 and to support international accounting standards (IAS). It was also decided that, while adopting mark-to-market accounting for profit determination as per IAS, IOD should report operating profits to the management according to the weighted average cost basis as well.

During 2003, IOD revised the existing guidelines on reserve management and completed the automation of dealing activities. The former involved two important tasks, (i) the complete revision of reserve management guidelines that were prepared in 1995 and (ii) setting up of an advanced counterparty credit risk management system (CCRMS). The latter involved the development of a treasury module by a local firm according to IOD's requirements and specifications and launching of the system by 2 January 2004. These measures enabled the Bank to strengthen dealer supervision, reduce risks in its foreign reserve management operations and enabled on-line measuring and monitoring of risks with improved efficiency in reserve management.

(c) Operating Instructions, Circulars and Directions Issued During 2003

(i) Limits of Daily Foreign Currency Working Balances

The limits on daily net foreign exchange open positions (NOP) of commercial banks were established as a prudential measure immediately prior to the introduction of the floating exchange rate regime in January 2001. At the time of its introduction in January 2001, this limit was imposed for each commercial bank at 10 per cent of its DBU capital inclusive of reserves, in respect

of positive (oversold) net foreign exchange open positions and thereafter revised to 15 per cent in March 2002.

The objective of setting limits was to contain any adverse speculative activity in the foreign exchange market following the floating of the currency. Given the stability in the foreign exchange market in 2003 and the necessity to further develop the market by way of increasing depth and flexibility, it was decided to raise the limit from 15 per cent of DBU capital to a maximum of 20 per cent of consolidated capital funds depending on the capital strength of individual banks, effective from 1 September 2003. The consolidated capital funds were used as the base for the limits, as the base for prudential requirements for capital adequacy were revised from DBU capital to consolidated capital (DBU and FCBU) in January 2003.

The limits on oversold (negative) exposure positions were left to be set internally by the management of the banks. Since the capital balances of the banks change over time, the limits will be revised annually on the basis of the audited financial statements.

(ii) Amendments to the Weekly Report on Commercial Bank on Foreign Currency Deposit Liabilities

CBSL issues a schedule of exchange rates, weekly to commercial banks for the purpose of converting their foreign currency deposit liabilities into US dollars and for reporting such balances to CBSL. This schedule included some of the Euro area legacy currencies as well. As the Euro area legacy currencies ceased to be legal tender since March 2002, those currencies namely, the Belgium Franc, Deutsche Mark, French Franc, Italian Lira and the Netherland Guilder were removed from the weekly report on foreign currency deposit liabilities with effect from 13 August 2003.

(iii) Foreign Currency Notes Purchases and Special Arrangements for the Purchase of Middle-East Currencies

In the past, CBSL was engaged in buying foreign currency notes particularly when the exchange rate bands were in operation and the local market was less developed and providing an agency function to the government by accepting currency notes confiscated by the Customs Department. With the introduction of the floating rate system and the well established practices adopted by several commercial banks for purchasing and repatriating foreign currency notes, CBSL discontinued the purchasing of foreign currency notes with effect from 25 April 2003.

Legal

The main functions of the Legal Department include advising the Bank on legal matters, representing the Bank in courts and other legal fora and contributing to the legal reforms in the banking and financial sector.

In 2003, the Legal Department continued to provide advice to the Bank on legal matters. In particular, the Department worked closely with the relevant operational departments to prepare amendments to legislation, rules, regulations and other legal documents to support the real-time gross settlement and the scripless securities settlement and depository systems. Amendments were introduced to the Local Treasury Bills Ordinance and the Registered Stock and Securities Ordinance to facilitate the proposed scripless securities settlement system.

The Department was also involved in a project undertaken by the Bank with the technical assistance of the World Bank and IMF to draft new central banking and banking legislation.

Management Audit

The Management Audit Department provides independent audit and advice to add value and improve Bank's operations and systems of control, so as to contribute towards achievement of strategic objectives of the Bank.

Under the restructuring initiatives of the Management Audit Department, several steps were taken to streamline the operations of the Department during the year. An Annual Audit Plan was prepared on a risk based audit approach. Audit staff was trained on a training plan formulated on the basis of individual skill gaps and training requirements. Steps have been taken to revise the Audit Manual to incorporate new audit practices and procedures. Pre-auditing activities were terminated in accordance with new audit charter and replaced with post audits. The follow up audit reviews were undertaken.

The Audit Committee of the Monetary Board, which was established during the year 2001 among other things, oversee the audit process, the financial statements of the CBSL, the related financial reporting practices and the system of internal controls.

The Annual Audit Plan 2003, which was prepared on a risk based audit approach has been implemented successfully during the year. More audit resources have been allocated on high and moderate risk operations. Extensive System Audits have been carried out in selected operations, while continuing with compliance auditing to maintain established internal controls.

The major audit activities undertaken include a general control review of IT Systems of CBSL (co-sourced with M/s. Ernst & Young), comprehensive review of processes in Currency Department, Review of processes in Payments & Settlements Department, Printing Press, CBSL Library, major payment processes in Welfare Department, Premises Department, Secretariat Department and Finance Department.

Various compliance audits were carried out on a regular basis as in previous years in operational and support service departments and Finance Department. Management Audit Department also performed several management evaluation studies with the objective of improving efficiency, economy and effectiveness of Bank's operations.

During the year the Department audited the unserviceable and damaged currency notes to the value of Rs.33 billion of various denominations prior to their destruction, and observed the work at the Currency Verification, Counting and Sorting (CVCS) Unit. The Department also carried out the annual verification of stocks of Gold, currency notes and coins. The Stock Registers of currency were checked and certified by the audit officers after reconciling receipts and issues. Fixed assets and other verifications were also carried out in several departments to verify furniture and fittings, office equipments, computers etc. and consumable stocks.

In addition to the above, Management Audit Department took part in project pre- implementation and systems review activities of RTGS/SSSS/GL Systems and TDRMS (Treasury Module) System.

Management Development Centre

The Management Development Centre (MDC), continued to conduct its High Level Training programmes (HLTP) in 2003, with the objective of updating and improving the professional skills and knowledge of the senior staff of the Central Bank. These training opportunities were also made available to other organisations to make training more effective through cross-fertilisation. The resource persons were world renowned eminent scholars in their respective fields.

In 2003, 13 HLTP were conducted mainly in the areas of Financial Crisis, Central Banking, Time Series Analysis, Exchange Rates, Investment Analysis, Institutional Economics, Economics of Taxation and Management Development for 388 participants (Table II-9).

In addition, MDC also conducted 03 Management Development programmes during 2003 for the Heads of Departments of a Central Bank with the objective of providing an opportunity to the senior officers of the bank to upgrade their managerial skills. As a continuation of this series, a special seminar on 'Building the Learning Organisation' was conducted in December 2003 so as to create a new learning culture in the bank, a sustainable way for the development of skills of officers for a future.

Payments and Settlements

The Payments and Settlements Department (PSD), which was established in 2002, with the objectives of ensuring the safety, efficiency, integrity and stability of the country's payment and settlement system, carried out a wide range of duties and functions during 2003. Among these were:

- Operating the Real Time Gross Settlement (RTGS) System;
- Monitoring RTGS System operations;
- Monitoring and operating the payment gateway for CBSL's own transactions;
- Overseeing the payment system;

TABLE II – 9
High Level Training Programmes conducted during 2003

Course Title	Duration	Resource Persons
1. Part I – Policy discussion on "Recent Developments and Issues in External Debt Management – Special Reference to Highly Trade Dependent Countries"	13 – 14 January, 2003 (2 days)	Professor Kenneth Miles Kletzer, Jr Department of Economics, University of California Santa Cruz USA.
Part II – Course on "Capital Flows, Financial Crises and Policies for Small Open Economies"	16 – 24 January, 2003 (6 days)	– do –
2. Part I - Policy discussion on "The Organizational Structure of the Bank Supervision"	31 January, 2003 (half-day - morning)	Prof. Charles A.E. Goodhart Advisor – Financial Regulation Bank of England
Part II – Course on 'Central Banking'	29 January 2003 (half-day), 30 January 5 February, 2003 (2 1/2 days)	– do –
3. Course on 'Time Series Analysis'	17 – 28 February (10 days)	Prof. Neil Dias Karunaratne School of Economics, University of Queensland, Brisbane Australia
4. Part I – Workshop on "Performance Management"	8 March, 2003 (01-day)	(1) Professor D. S. Withane Head, Dept. of Management and Labour Studies, Odette School of Business, Faculty of Business Admin. University of Windsor, Canada. (2) Dr. Jagdish Pathak Assistant Professor of Accounting Systems and IT Auditing Louise & Edmond Odette School of Business University of Windsor, Canada.
Part II – Course on "Management Development Programme – Organizational Effectiveness, Control and Performance"	10 – 13 March, 2003 (4 days)	
5. Executive Development Workshop on "The Dynamics of Leading and Leadership Challenges Today: An integrative Paradigm"	22 – 23 March, 2003 (2 days)	– do –
6. Part I – Policy Discussion on "Indonesia in the Asian Crisis – 1997 to 2000: From a Policy Maker's Perspective"	19 – 20 May, 2003 (2 days)	Prof. Charles George Fane Australian National University, Australia
Part II – Course on "Capital Mobility, Exchange Rates and Economic Crises"	21 – 30 May, 2003 (8 days)	– do –
7. Course on "Investment Analysis"	30 June – 11 July, 2003 (10 days – Afternoon)	Prof. Lalith P. Samarakoon Associate Professor, College of Business University of St. Thomas, Minneapolis, USA.
8. Course on "Institutional Economics for a Developing Economy"	04 – 08 August, 2003 (5 days)	Prof. Pranab Kumar Bardhan Professor of Economics, Institute of International Studies University of California, Berkeley, USA.
9. Course on "Economics of Taxation"	08–16 September, 2003 (7 days)	Prof. Raghbendra Jha Australian National University, Canberra, Australia
10. Workshop on "Research Methodology and Hands-on Econometrics"	13-14 September, 2003 (2 days)	Dr. Jayasinghe Wickramanayake Dept. of Accounting and Finance, Monash University,Australia
11. Workshops on "Fixed Income Securities" <u>1st Programme</u> – 'Introduction to Fixed Income Mathematics (IFM)	22 – 24 September (3 days)	Mr. Stephen Bate and Mr. Paul Kitching, Euro Finance, London.
12. <u>2nd Programme</u> – 'Advanced Fixed Income Strategies and Risk Management (AFS)	25-28 September, 2003 (4 days)	Mr. Paul Kitching Euro Finance, London.
13. Seminar on "Building the Learning Organisation"	10 – 11 December, 2003 (2 days)	Professor Michael Marquardt George Washington University, USA.

- Processing and effecting the Intra Day Liquidity Facility (ILF);
- Processing and effecting payment and settlement instructions of CBSL's own transactions relating to foreign exchange management and Open Market Operations (OMO), while ensuring compliance with procedures and guidelines;
- Effecting transactions under the Asian Clearing Union (ACU);
- Handling SWIFT Communication; and
- Collecting, compiling and analysing data relating to the payment and settlement system and preparing the Payments Bulletin to enhance the general understanding and awareness of the public about the payment and settlement system.

Operating the RTGS System

During 2003, PSD actively participated in almost all steps in launching the LankaSettle System and automated General Ledger System. These involved studying project documents to understand features and identify issues and potential risks; assisting the design of system rules; participating in testing the LankaSettle System; and training PSD staff. PSD had a continuous dialogue with the participating institutions, as well as the relevant departments of CBSL, to familiarise them with the LankaSettle System. To ensure a smooth transition to the new RTGS System, an RTGS Operations Division was set up within PSD. The Division opens the RTGS System for business at 0800 hours and closes the system for business at 1600 hours each business day.

The RTGS Operations Division of PSD was responsible for the daily operations of the RTGS System and providing help desk services to participants throughout the operating hours of the System. The Division was involved in system pre-start activities, submitting account transfer files, including retail clearing balances transmitted by LankaClear Pvt. Ltd., and maintaining RTGS system static data. During 2003, the Division made 31 direct account transfers to assist participants in unforeseen technological problems (particularly in SWIFT communication), prepared daily information to the senior management of CBSL, closely monitored funds availability in Settlement Accounts to ensure smooth settlement of clearing balances, CBSL's outward payments, participants' queued payments, rejected payment instructions, status of different payment categories at specific cut off times, and initiation and reversal of ILF etc.

Monitoring of RTGS System Operations

PSD was engaged in on-site monitoring of RTGS System operations to ensure compliance of participants with rules, regulations and guidelines and to identify any possible systemic problem; and off-site monitoring of participants' contingency event recording.

Monitoring and Operating the Payment Gateway of CBSL's Own Transactions

In order to have close control and maintain the security of CBSL's own payments made through the RTGS System, PSD closely monitored and effected manual file transfer of the incoming and outgoing RTGS payments of CBSL.

Oversight of Payment System

Oversight of the payment system was focused on ensuring smooth, safe and efficient operations of the payment system as a whole, in line with the ten core principles published by the Committee on Payment and Settlement Systems (CPSS) of the Bank for International Settlements (BIS), and internationally accepted technical standards.

Oversight activities included off-site surveillance of the clearing systems operated by LankaClear Pvt. Ltd. (LCPL) and regular collection of information on payment and settlement systems and close dialogue with LCPL, LCBs, PDs and other payment service providers. During 2003, PSD continued its function of overseeing the clearing activities of LCPL in order to ensure smooth clearing operations in line with the Daily Operating Schedule of the LankaSettle and to monitor its operations to identify any operational issues and risks. Periodic reports were obtained from LCPL to identify policy issues and to prepare the quarterly Payments Bulletin.

Processing and Effecting of Intra day Liquidity Facility

PSD engaged in work relating to the provision of Intra-day Liquidity Facility (ILF) to the participants of the RTGS System against government securities, i.e. Treasury bills and Treasury bonds. In this context, PSD accepted government securities, calculated the amount of ILF against the underlying securities, prepared relevant source-documents to facilitate accounting records and acted as the custodian of underlying securities.

During the period 8 September to end December 2003, 17 participating institutions obtained ILF amounting to Rs.500 billion, with the highest daily value being Rs.13.3 billion and the daily average being Rs.6.5 billion. ILF requests, which were high at the commencement of the RTGS System mainly for precautionary reasons, gradually reduced by the end of the year.

Settlement of Deals under Foreign Exchange Reserve Management

The Forex, Gold and Foreign Securities Settlement Division of PSD actively participated in developing and implementing a bespoke Treasury Dealing Room Management System (TDRMS), consisting of a back-office module for the Payments and Settlements Department and a front office module for the International Operations Department (IOD). This involved automating the back-office operations of transactions entered

TABLE II – 10
Deals in Forex, Gold and Foreign Securities in 2003

Month	Foreign Exchange		Gold		Foreign Securities		Fixed Deposits	
	No. of deals	Value (US \$ mn.)	No. of deals	Value (US \$ mn.)	No. of deals	Value (US \$ mn.)	No. of deals	Value (US \$ mn.)
January	122	226.1	13	35.1	56	310.1	62	468.1
February	31	33.1	4	9.1	78	535.0	83	465.6
March	27	114.4	–	–	91	630.0	74	916.6
April	34	141.2	–	–	77	357.0	65	719.4
May	17	20.1	–	–	107	665.9	57	631.4
June	38	85.5	–	–	101	752.2	57	701.8
July	68	149.0	–	–	82	449.0	56	668.8
August	44	78.5	–	–	104	46.8	38	477.9
September	52	101.0	–	–	92	67.1	51	576.8
October	52	150.6	2	18.3	133	248.6	50	428.3
November	19	64.6	–	–	47	66.9	43	371.7
December	44	72.7	1	10.3	65	47.4	58	453.4
Total	548	1,236.8	20	72.8	1,033	4,176.0	694	6,879.8

Source : Central Bank of Sri Lanka

into by IOD under foreign exchange reserve management. The main areas covered by the TDRMS back-office module were effecting payment and settlement instructions, communication between counterparties through SWIFT, and posting transactions to the General Ledger of CBSL. The TDRMS back-office module changed the manual processing of settlement instructions and introduced electronic verification and authentication by PSD with proper user access rights. This helped PSD to minimise the settlement risk.

During 2003, the Forex, Gold and Foreign Securities Settlement Division effected settlement instructions, resolved settlement problems, monitored the nostro balances of foreign currency accounts and safe custody balances of holdings of securities held with counterparties abroad. PSD settled 2,295 deals with foreign counterparties in foreign exchange, gold, fixed deposits and foreign securities, amounting to US dollars 12,365 million. The total number of foreign exchange deals dropped from 7,423 in 2002 to 548 in 2003. The total number of transactions on foreign securities and gold recorded decreases, while that of fixed deposits recorded a 60 per cent increase in 2003 when compared with 2002.

Settlement of CBSL's Transactions under Open Market Operations (OMO)

During 2003, the OMO Settlement Division of PSD continued the settlement of OMOS carried out by CBSL with LCBs and PDs. Before the implementation of the RTGS System, the settlement of open market transactions was deferred and settled on net basis at the end of the day. With the implementation of the RTGS System, participating institutions settled their payments, in the case of Repurchase (Repo) transactions, through their RTGS settlement accounts by the stipulated cut off time. CBSL credited the maturity proceeds of Repos to the settlement accounts of LCBs or PDs at the beginning of the relevant maturity dates.

OMO Settlement Division effected 6,292 settlement instructions on Repo transactions amounting to Rs.2,446 billion, 21 secondary (outright) sales amounting to Rs.3 billion, and 9 Reverse Repo transactions amounting to Rs.7.5 billion in 2003.

TABLE II – 11
OMO Transactions in 2003

Month	Repo Transactions		Secondary Sales		Reverse Repo Transactions	
	No. of Transactions	Value (Rs.bn)	No. of Transactions	Value (Rs.bn)	No. of Transactions	Value (Rs.bn)
January	422	270.8	7	0.4	–	–
February	344	201.1	4	0.2	–	–
March	524	195.1	–	–	1	0.05
April	484	125.3	–	–	2	3.35
May	452	189.6	–	–	6	4.06
June	604	280.7	–	–	–	–
July	744	284.5	6	1.5	–	–
August	637	218.6	2	0.1	–	–
September	664	241.3	2	0.7	–	–
October	525	145.2	–	–	–	–
November	428	129.2	–	–	–	–
December	464	163.9	–	–	–	–
Total	6,292	2,445.5	21	3.0	9	7.46

Source: Central Bank of Sri Lanka

Transactions under the Asian Clearing Union (ACU)

The total value of transactions of Sri Lanka effected through the ACU mechanism increased by 30 per cent from Rs.77 billion in 2002 to Rs.100 billion in 2003, due mainly to increased imports, particularly crude oil and other petroleum products from India (Rs. 21 billion) and the Islamic Republic of Iran (Rs.25 billion). The total value of imports to Sri Lanka from other ACU countries recorded a growth of 30 per cent to Rs.136 billion in 2003, when compared with the previous year.

TABLE II – 12
Trade and ACU Transactions of Sri Lanka with other ACU Countries

Item	2002	2003	Change (a) %
Total transactions channelled through ACU	77.1	100.3	30
Sri Lanka's exports to other ACU countries	23.5	31.9	35
Sri Lanka's imports from other ACU countries	104.2	135.6	30
Sri Lanka's total trade with other ACU countries	127.7	167.4	31
Net ACU Settlements	67.5	89.7	33

(a) Provisional

Source: Central Bank of Sri Lanka

The total export earnings received from other ACU countries recorded an increase of 35 per cent in 2003, when compared to 2002 mainly due to increased exports to India and Pakistan. The rupee value of net settlements made under the ACU mechanism during 2003 amounted Rs.90 billion, an increase of 33 per cent over 2002.

ACU Technical Committee Meeting 2003

At the Board of Directors' Meeting of ACU held in Colombo in 2002, it was decided that the Technical Committee of ACU would meet again to examine the future role of ACU with the assistance of ESCAP/UNCTAD. A revisit of the role of ACU was necessitated in the context of the developments taking place in the region, which included formation of several groups for trade promotion and economic co-operation.

Accordingly, a meeting of the members of the Technical Committee was held in Bangkok on 9 April 2003 and the Technical Committee presented its recommendations at the 32nd Meeting of the Board of Directors of ACU.

Thirty Second Meeting of the Board of Directors of the ACU

The 32nd Meeting of the Board of Directors of the Asian Clearing Union was held in Bangalore, India, on 16-17 June 2003. The Governor of the Reserve Bank of India, the Chairman of ACU for the year 2003/2004, presided at the meeting. Directors/Alternate Directors and other delegates from the eight member central banks/monetary authorities of Bangladesh, Bhutan, India, Iran, Myanmar, Nepal, Pakistan and Sri Lanka attended the meeting. Officials of the ACU Secretariat in Iran and observers from the Bank of Thailand and ESCAP also attended the meeting.

The Board of Directors reviewed the following recommendations made by the ACU Technical Committee on the 'Future Role of ACU':

(i) The focus of ACU mechanism should continue to be on payments and settlement of cross border transactions as given in its mandate and there was no immediate need for any change in the mandate given to ACU for the present. The ACU mechanism will, thus, continue to

provide the facility to settle, on a multilateral basis, payments for current international transactions among member countries and thus economise on the use of foreign exchange reserves;

- (ii) The neighbouring countries could be invited to join ACU through persuasion and by discouraging bilateral agreements on related areas at the same time;
- (iii) All the member countries which have not initiated introduction of the SWIFT system for sending messages on transactions could do so at the earliest to facilitate faster settlement of payments;
- (iv) In the medium to long term, ACU member countries should aim at setting up a Central Clearing House (CCH) to facilitate faster, risk free clearing and settlement of ACU transactions, by sharing operational costs;
- (v) The ACU Secretariat's proposal for further expansion of its activities into three major areas comprising accounting, information and data center and monetary studies could be considered with the consent of the Board of Directors at an appropriate time, in the future;
- (vi) The proposal for the creation of a Fund to help the ACU Secretariat to meet expenses related to engaging consultants, sending experts to target countries for follow up of previous endeavours to persuade them to become members etc. could be renewed at the forthcoming meeting of ACU Directors;
- (vii) The delays in payments to exporters, which continue to persist under the ACU mechanism, could be eliminated by following the laid down procedures scrupulously by banks in member countries. Central banks may have to monitor the position in this regard, vigorously;
- (viii) Use of currencies other than the US dollar may be encouraged for settlement under the ACU mechanism as per provisions available under Section 11, Chapter V of the ACU Memorandum; and
- (ix) There is need to work out a strategy for bringing about improvement in the working of ACU mechanism, specifying a time frame, starting with elimination of existing bottlenecks and moving to setting up a CCH coupled with an integrated RTGS set up for the region to make ACU mechanism a preferred arrangement for settlement of payments in the region.

The Chairman proposed following three areas for the ACU Secretariat to take measures to implement the Committee's recommendations either in the short term or in the medium term:

- (i) improvement of technology coupled with removal of bottlenecks which are hampering the smooth functioning of ACU;
- (ii) enhancing the membership of ACU; and
- (iii) exchange of information between the member banks on a larger scale.

The Board of Directors endorsed the proposals unanimously for implementation by the ACU Secretariat.

The Board elected the Governor of the Central Bank of the Islamic Republic of Iran as the Chairman and the Governor of the State Bank of Pakistan as the Vice Chairman of ACU for the year 2004/2005. The 33rd Meeting of the Board of Directors of ACU will be held in Iran in 2004.

SWIFT Communications

During 2003, the SWIFT Communication Division of PSD handled a wide range of SWIFT related activities, including entering outgoing messages, reading and sorting incoming messages, and taking action and/or forwarding the incoming messages to the relevant Divisions/Departments of CBSL for necessary action. The following work relating to creating an operating environment for testing and implementing the LankaSettle System and TDRMS was also undertaken:

- Signing SWIFT Alliance Access contract to implement LankaSettle with SWIFT;
- Migration of the SWIFT Alliance Access (SAA) from Windows NT platform to AIX version 5.0 in July 2003;
- Training of SWIFT operators of CBSL and LankaSettle participants;
- Bilateral Key Exchange (BKE) for test and training and live operations;
- Upgrading of SWIFT Alliance Message Partner to use the 2003 message standards by introducing MT 103 (Single Customer Credit Transfer Message) in place of SWIFT MT 100; and
- Conducting of a drill session to test the telephone authentication procedure between CBSL and SWIFT Customer Services Center.

TABLE II-13
SWIFT Messages flows relating to CBSL Transactions

Month	No. of Outgoing SWIFT Messages		No. of Incoming SWIFT Messages	
	2002	2003	2002	2003
January	3,175	1,573	3,708	2,668
February	3,680	889	4,349	2,357
March	2,709	966	3,952	2,338
April	3,438	916	3,863	2,447
May	2,498	1,179	3,701	2,527
June	3,009	1,831	3,820	2,304
July	4,709	1,869	5,537	3,168
August	4,219	1,462	4,802	6,865
September	991	2,437	1,944	6,141
October	1,166	2,378	2,065	14,685
November	1,251	2,043	2,179	13,780
December	1,227	2,667	2,054	19,885
Total	32,072	20,210	41,974	79,165

Source: Central Bank of Sri Lanka

The SWIFT Communication Division handled 79,165 incoming SWIFT messages in 2003 which showed a 89 per cent increase when compared with 2002 due mainly to testing of messages of LankaSettle System and effecting RTGS transactions. However, the total number of outgoing SWIFT messages of CBSL dropped by 37 per cent to 20,210 due mainly to reduced settlement messages in respect of dealings under foreign exchange reserve management. The SWIFT Communication Division effected 395 tested telex messages in 2003.

Public Awareness on Operating of Payment Systems

PSD continued to collect, compile and disseminate information on payment and settlement systems in the country to enhance public awareness, and facilitate further development, research and policy decisions in payment and settlement arrangements. During 2003, the quarterly 'Payments Bulletin' was published, containing details and analysis on the payments and settlement systems of the country, statistics on each payment mode and system, and feature articles on contemporary subjects in payments and settlements.

In addition, PSD collected information required for preparing a document named Red Book on 'Payment Systems in Sri Lanka' to be sent to BIS to be published. In connection with the launching of the RTGS System, PSD prepared and published a booklet 'LankaSettle-RTGS System' describing the technological, operational, and administrative features of the RTGS System.

Premises

The Premises Department continued to carry out maintenance and upkeep of the Bank's premises during 2003, 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 lower cost.

By the end of 2003, all departments of the Bank have been provided with modern furniture, thereby providing further conveniences to the employees and a conducive working environment.

The foundation stone for the construction of the Regional Development Training Complex with residential facilities at Mandandawala in Matale was laid on 20 December 2003. This Complex will also house the Regional Office of the Central Bank.

The Department continued to maintain the Light House Clock Tower adjacent to the Bank's Head Office.

Public Debt

The year 2003 witnessed many a landmark achievement in the sphere of public debt management and debt market development. Measured in terms of key indicators such as debt sustainability, cost of borrowing, fiscal solvency and risk sensitivity of the debt profile, an improvement was clearly evident in public debt management. The extension of the yield curve up to 20 years, increased tradability and liquidity of long term debt instruments, further phasing out of the Rupee loan programme, early retirement of high cost callable Rupee loans, strengthening the institutional, legal and market framework for issue and trading of scripless securities, introduction of a screen based trading platform for government bonds, adoption of a Code of Conduct for Primary Dealers (PDs) and initiatives taken in regard to a sovereign rating were noteworthy steps taken in this regard.

In terms of the Section 106(1) of the Monetary Law Act (MLA), 'The Central Bank shall act as the fiscal agent and banker to the government or agencies or institutions acting on behalf of the government, whether established by any written law or otherwise'. Furthermore, as per the Section 113 of MLA, the Monetary Board and the Central Bank are vested with the function of debt management, which stipulates that 'the Central Bank shall, as agent of the government, be responsible for the management of the public debt'. In Sri Lanka, the raising of debt by the government requires the scrutiny by the Monetary Board as per the Section 114 of MLA, which states that 'no new loan shall be raised and no new issue of stock or debenture shall be made by the government or by any agency or any institution referred to in subsection (1) of Section 106, whether in pursuance of authority conferred by any written law or otherwise, unless the advice of the Monetary Board has first been obtained upon the monetary implication of the proposed loan or issue'.

The annual Appropriation Act authorises the raising of loans "in or outside" Sri Lanka, on behalf of the government, to provide for the annual expenditure of the government. It determines aggregate amount of such borrowing, although this may be revised during the year with supplementary legislation. PDD acts as the agent of the government for domestic borrowing, through Treasury bonds, Treasury bills, Rupee loans and Sri Lanka Development Bonds (SLDBs). Domestic debt is raised by PDD as per provisions of the Registered Stocks and Securities Ordinance (RSSO), Local Treasury Bills Ordinance (LTBO), Treasury Certificates of Deposit Act (TCDA) and Tax Reserve Certificates Act (TRCA). SLDBs, which are considered as domestic debt, are issued in terms of the Foreign Loans Act. During the last few years, no TCDs or TRCs were issued by PDD. PDD services both domestic and foreign debt. In addition to PDD, the Treasury also raises public debt. Foreign debt is raised by the Treasury through the External Resources Department.

The main objective of PDD is to manage the public debt to ensure that the government's financing needs and its payment obligations are met at the lowest possible cost over the medium to long term, consistent with a prudent degree of risk. The Domestic Debt Management Committee (DDMC), a sub-committee set up for this purpose, meets monthly, or more frequently if necessary to decide on the borrowing programme in the immediate future, while meeting cash flow requirement of the Treasury and maintaining the budgetary limits. A close coordination between the State Accounts Department of the Treasury and PDD is maintained to ensure an efficient management of the government's cash flow and public debt.

Developments in 2003

Debt Issuance and Cost

In terms of the Appropriation Act, No. 31 of 2002 approved by Parliament for 2003, the total gross borrowing limit of the government amounted to Rs.316 billion. This limit was enhanced to Rs.375.7 billion by the end of 2003, mainly to accommodate the early retirement of callable Rupee loans, which amounted to Rs.33.4 billion. PDD followed a well-planned borrowing programme and an appropriate mix of short and long term instruments, among other things, to lower the cost of borrowing in 2003. This effort was facilitated by favourable macroeconomic conditions such as low inflation expectations and low interest rates that prevailed since the second half of 2002.

The total outstanding public debt as at end of 2003 amounted to Rs.1,833.4 billion. As shown in Table II-14, the share of non-tradable debt such as Rupee loans declined sharply, as a result of a conscious effort made to improve the tradability of debt instruments and competitiveness of the market. Consequently, increased public debt was represented by Treasury bills and Treasury bonds and by end 2003

TABLE II – 14
Composition of Public Debt (a)

Category	At end 2002 Rs. Mn.	%	At end 2003 Rs. Mn.	%
Domestic Debt	899,040	55.9	993,104	54.2
Treasury bills	210,995		219,295	
Treasury bonds	287,700		248,414	
Rupee loans	347,128		487,504	
Sri Lanka Development Bonds	24,181		8,852	
Borrowing from FCBUs	29,018		29,021	
TCDs	11		11	
TRCs	7		7	
Foreign Debt (b)	710,495	44.1	840,256	45.8
Total	1,609,535	100.0	1,833,360	100.0

Source : Central Bank of Sri Lanka

(a) Debt managed and serviced by the Public Debt Department

(b) Provisional

outstanding public debt covering these two instruments amounted to Rs.219.3 billion and Rs.487.5 billion, respectively. This was an increase of Rs.8.3 billion and Rs.140.4 billion respectively, as compared with that of the previous year. The composition of total debt reflected an increase in the share of foreign debt. Consequently, the share of domestic debt in total public debt declined from 56 per cent in 2002 to 54 per cent in 2003, while that of foreign debt increased from 44 per cent to 46 per cent. However, the domestic market continued to remain the main source of government borrowing accounting for more than three fourth of the total borrowing in 2003.

Table II-15 show that, in conformity with prudent debt management policies, net new issues of debt were made through tradable instruments such as Treasury bills and Treasury bonds. Accordingly, the existing debt on non-tradable instruments such as Rupee loans in 2003 was reduced and this included a net repayment of Rupee loans amounting to Rs.39.3 billion. In 2003, one strategy adopted in debt management was to issue more medium to long-term Treasury bonds and to gradually establish a yield curve for long term tradable securities such as 10-year, 15-year and 20-year Treasury bonds.

TABLE II – 15
Issue and Maturity of Domestic Debt in 2003

	Maturity	Issues	Repayments	Net Issues Rs. Million
Treasury Bills	91 day	122,466	125,071	(2,605)
	182 day	40,232	40,425	(193)
	364 day	144,273	146,369	(2,096)
	Other	35,876	22,682	13,194
	Total	342,847	334,547	8,300
Treasury Bonds	2 year	3,000	27,566	(24,566)
	3 year	20,250	27,951	(7,701)
	4 year	35,600	18,904	16,696
	5 year	43,700	–	43,700
	6 year	68,000	–	68,000
	10 year	33,950	–	33,950
	13 year	4,397	–	4,397
	15 year	4,900	–	4,900
	20 year	1,000	–	1,000
	Total	214,797	74,421	140,376
Rupee Loans	2 year	–	19,500	(19,500)
	2/5 year	44,372	27,000	17,372
	2/6 year	3,741	–	3,741
	4/5 year	–	5,500	(5,500)
	5 year	–	10,000	(10,000)
	5/7 year	–	19,000	(19,000)
	7/8 year	–	5,400	(5,400)
	8/10 year	–	1,000	(1,000)
	Total	48,113	87,400	(39,287)
	Sri Lanka Dev. Bonds (US \$ 158.5 Mn.)	2 year	–	15,179 (15,179)
		Total	–	15,179 (15,179)
Loans from FCBUs	Total	–	–	–
Total		605,757	511,547	94,210

Source : Central Bank of Sri Lanka

This helped to reduce the rollover risk, and provided stability in the debt market. The maturity periods of Treasury bonds were increased with the inaugural 10-year Treasury bond issue in January 2003, which followed 15-year and 20-year Treasury bonds issued in February and October 2003, respectively. Issue of short-term Treasury bonds was limited to Rs.3.0 billion with two year maturity during 2003.

The development of a long term yield curve in the government debt securities market extending up to 20-years in 2003 was a landmark achievement. The government debt market yield curve, among other things, provided a benchmark for pricing of corporate bonds and other long term private securities. A much wider maturity structure than ever before with regular issuances of Treasury bonds during 2003 strengthened the debt market with enhanced tradability and liquidity of long term debt instruments.

On 14 November 2003, Treasury bonds with a maturity of 13-years for Rs.4,397 million at zero rate of interest were issued to six commercial banks in order to facilitate the privatisation process of the Corporative Wholesale Establishment (CWE).

To give effect to a budget proposal for 2003 of reducing the interest cost of the existing debt, PDD took steps to retire callable Rupee loans amounting to Rs.33.4 billion, which carried interest rates of 13 per cent and above. Funds required to retire these Rupee loans were raised mainly by issuing Treasury bonds and total interest savings for the government from this exercise has been estimated to be around Rs.4.6 billion.

As shown in Tables II-17 and II-18, average yield rates of government securities fell sharply. A sharp decline in market interest rates was observed following the gradual reduction of the CBSL's policy interest rates. In a framework of increasingly favourable macroeconomic conditions, which provided a

TABLE II – 16
Issue and Repayment of Rupee Loans – 2003

	Interest Rate (% p.a.)	Maturity Period (Years)	Amount (Rs. Mn.)
Floated	8.00	2/6	2,538.3
	9.25	2/6	1,200.0
	11.00	2/5	23,700.0
	13.00	2/5	20,675.0
	Total		48,113.3
Repaid	11.00	5	10,000.0
	12.00	4-5	5,500.0
	13.00	2-5	13,100.0
	13.00	7-8	5,400.0
	14.00	5-7	19,000.0
	15.00	2	19,500.0
	15.00	2-5	13,900.0
	15.50	8-10	1,000.0
	Total		87,400.0

Source : Central Bank of Sri Lanka

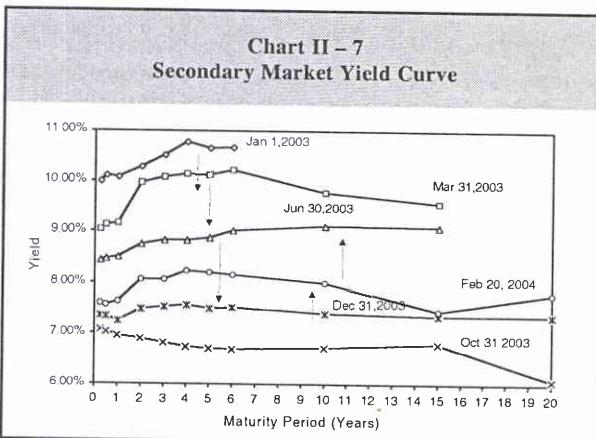
TABLE II – 17
Annualised Weighted Average Yield Rates of Treasury Bills, Treasury Bonds and Rupee Loans

Instrument	Per cent per annum					
	1998	1999	2000	2001	2002 (a)	2003 (a)
Treasury Bills (days) (b)						
91	11.78	11.69	12.80	16.09	12.69	9.13
182		12.12	12.03	12.94	17.32	12.90
364		12.22	12.55	14.14	18.34	13.84
Overall average	11.09	12.06	13.62	17.37	13.23	9.07
Treasury Bonds (Years)						
2	12.84	13.01	16.71	19.82	14.88	10.75
3	13.43	13.31	15.00	15.60	14.29	9.69
4	13.72	13.53	12.52	–	14.54	9.97
5	–	13.78	12.78	–	14.69	10.97
6	–	13.65	12.88	–	14.83	9.56
10	–	–	–	–	–	8.72
13	–	–	–	–	–	–
15	–	–	–	–	–	9.01
20	–	–	–	–	–	6.66
Overall average	13.08	13.37	15.10	18.07	14.57	9.59
Rupee Loans (Years) (c)						
2	–	–	–	15.00	–	–
5	11.35	–	–	14.03	13.00	11.93
6	12.00	–	11.00	–	–	8.40
7	11.25	–	–	–	–	–
8	12.25	12.25	–	–	–	–
10	11.50	12.50	12.00	13.00	–	–
Overall average	11.61	12.36	11.68	14.31	13.00	11.66

Source : Central Bank of Sri Lanka

- (a) Includes 10% withholding tax. Effective from 3 May 2002, government has imposed withholding tax on interest of Government Securities.
- (b) The issue of Treasury bills with maturities of 91 days, 182 days, and 364 days in place of 3, 6, 12 month maturities respectively, commenced in October, 1999.
- (c) For callable Rupee loans the compulsory date (maximum date) of repayment was considered.

cushion and flexibility, effective planning and execution of the borrowing programme supported by continuous monitoring of government cash flows facilitated the achievement of the debt management process. Interest rates of domestic debt eased further as the government resorted to foreign borrowings



amounting to Rs.87.3 billion in 2003. The interest rates in the secondary market too declined following the trends emerged in the primary market. SLDBs amounting to US dollars 158.5 million (Rs.15.2 billion) which matured in November and December, 2003 were redeemed as planned.

Chart II-7 depicts the secondary market yield curve for government securities. The yield curve shifted downward until early November 2003, when the rates started moving upwards with a high risk premium being demanded by investors due to factors exogenous to the debt market. This increase in the yield rates in December 2003 prompted PDD to issue securities with shorter maturities. However, overall government debt securities yield rates prevailed towards the end of the year were much lower than what they were at the beginning of the year.

In line with the downward trend in the yields on government securities since June 2003, interest rates of Rupee loans and coupon rates of Treasury bonds were revised downward as indicated in Table II-18.

TABLE II – 18
Interest Rates of Rupee Loans and Coupon Rates of T-Bonds in 2003

Month	Jan-03	Feb-03	Jul-03	Aug-03	
Rupee Loans*	13.00	11.00	9.25	8.00	
Coupon Rates of T-Bonds	2 Year 3 Year 4 Year 5 Year 6 Year 10 Year 15 Year 20 Year	12.50 10.25 10.00 9.75 9.50 8.50 8.50 –	12.50 10.25 10.00 9.75 9.50 8.50 8.50 –	12.50 10.25 10.00 9.75 9.50 8.50 8.50 7.00	8.00 7.90 7.80 7.70 7.60 7.50 7.50 –

Source : Central Bank of Sri Lanka

* Interest rate of Rupee Loans was revised downward to 6.50% in November, 2003.

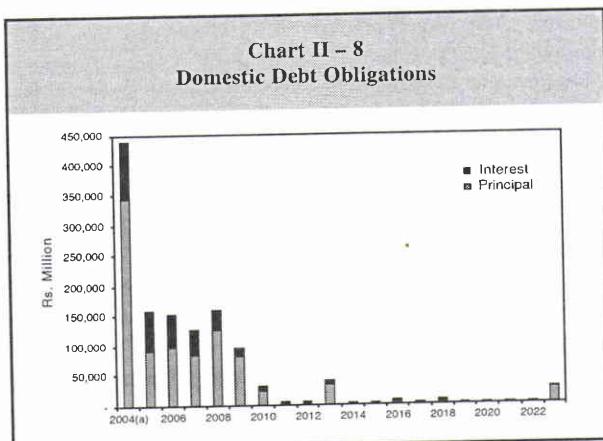
Table II-19 provides detailed information on Treasury bonds issued during the year. The number of series of Treasury bonds issued in 2003 was much lower at 26 compared to 51 in 2002. This reduction was made through a conscious effort to bring down the number of series of Treasury bonds issued to the market in order to facilitate secondary market activities by way of developing a few benchmark maturities.

Chart II-8 provides a summary of future domestic debt obligations estimated on the basis of total debt outstanding as at end 2003. The average duration of the domestic debt stock as at 31 December 2003 was 2.32 years as compared to 1.97 years in 2002. The duration of domestic debt is the weighted average maturity of domestic debt where the present value of payment obligations (cash out flows) are used as weights. The average interest rate of domestic debt as at end 2003 stood at 11.44 per cent as compared to 13.13 per cent as at end 2002.

TABLE II – 19
Information on Primary issue of Treasury Bonds – 2003

Bond Title	Maturity (Years)	Bids Received (Rs. Mn.)	Bids Accepted (Rs. Mn.)	W.A.Y.R to Maturity (% p.a)/ Range	Coupon Rate (% p.a.)
08.00% 2005 A	2	500	500	8.31 - 8.31	08.00
12.50% 2005 A	2	7,780	2,500	11.24 - 11.24	12.50
07.90% 2006 A	3	14,145	7,500	8.25 - 8.27	07.90
10.25% 2006 A	3	25,357	12,750	10.05 - 11.49	10.25
07.80% 2007 A	4	17,665	7,000	8.20 - 8.60	07.80
07.80% 2007 B	4	2,500	2,500	7.38 - 8.30	07.80
10.00% 2007 A	4	46,370	20,600	10.12 - 11.53	10.00
10.00% 2007 B	4	9,715	5,500	9.71 - 10.11	10.00
07.70% 2008 A	5	10,715	3,500	7.85 - 8.50	07.70
09.75% 2008 A	5	37,203	20,000	10.96 - 11.26	09.75
09.75% 2008 B	5	17,675	8,200	9.91 - 10.89	09.75
11.75% 2008 A	5	25,959	12,000	11.18 - 12.24	11.75
07.60% 2009 A	6	47,569	18,000	7.43 - 8.92	07.60
07.60% 2009 B	6	30,920	14,250	7.41 - 8.61	07.60
09.50% 2009 A	6	18,382	9,750	11.04 - 11.28	09.50
09.50% 2009 B	6	40,302	14,000	9.51 - 10.05	09.50
11.50% 2009 A	6	23,760	12,000	11.23 - 12.31	11.50
07.50% 2013 A	10	35,959	17,700	7.61 - 8.99	07.50
07.50% 2013 B	10	6,935	4,250	7.39 - 7.39	07.50
08.50% 2013 A	10	25,340	10,000	9.50 - 10.11	08.50
08.50% 2013 B	10	7,545	2,000	9.45 - 9.45	08.50
00.00% 2016 A	13	4,397	4,397	0.00 - 0.00	00.00
07.50% 2018 A	15	6,690	3,000	8.48 - 8.48	07.50
08.50% 2018 A	15	3,405	1,500	10.09 - 10.09	08.50
08.50% 2018 B	15	400	400	8.89 - 8.89	08.50
07.00% 2023 A	20	4,240	1,000	6.75 - 6.75	07.00
Total		471,428	214,797		

Source : Central Bank of Sri Lanka



PDD conducted 53 auctions each for Treasury bills and Treasury bonds, which were largely oversubscribed. The auctions were conducted electronically using the on-line computer based system introduced in 2000. During 2003, total gross issue of Treasury bills and Treasury bonds amounted to Rs.342.8 billion and Rs.214.8 billion, respectively. Total bids received at the auctions in respect of Treasury bills amounted to Rs.690.1 billion in respect of the amount offered totalling Rs.279.0 billion. Total bids received at the auctions of Treasury bonds were Rs.322.3 billion in respect of Rs.79.7 billion offered

for sale by auctions. Treasury bonds issued by way of placements to large institutional investors amounted to Rs.135.1 billion thus making the total Treasury bond issues during 2003 to Rs.214.8 billion.

Treasury bills and Treasury bonds were issued in scrip form during 2003. Detailed information on such scrip certificates in respect of Treasury bills, Treasury bonds and Rupee loans issued and serviced during 2003 is given in Table II-20.

TABLE II – 20
Number of Scrips Issued and Serviced during 2003

	Instrument	No. of Scrips		Amount (Rs. Mn.)
		Issued	Matured	
T-Bills	Issued	152,554		342,847
	Matured		137,771	334,547
T-Bonds	Issued	9,507		214,797
	Matured	9,446		74,421
	Coupons	220,056		44,838
Rupee Loans	Issued	119		48,113
	Matured	268		87,400
	Interest Warrants	1,250		35,574

Source : Central Bank of Sri Lanka

TABLE II – 21
External Debt Disbursements and Principal Repayments in 2003 and Outstanding Amount as at end 2003 (a) (b)

Category	Disbursements		Principal Repayments		Outstanding	
	2002	2003(c)	2002	2003(c)	2002	2003(c)
1. Donor	47,623	87,536	22,686	25,433	710,495	840,256
Bilateral	18,835	29,786	15,122	16,344	348,627	398,797
Multilateral	23,787	41,119	5,839	7,066	341,327	405,006
Commercial	–	10,082	597	646	7,849	17,566
Export Credits	5,001	6,549	1,128	1,377	12,692	18,887
2. Use of Funds	47,623	87,536	22,686	25,433	710,495	840,256
Cash	–	–	212	213	1,354	1,220
Commodity	317	–	3,091	3,018	30,157	30,659
Food	–	–	1,645	1,715	36,928	35,069
Goods & Services	905	2,321	–	–	916	3,232
Military	–	–	–	–	875	873
Programme	6,389	33,012	1,620	1,394	56,648	94,666
Project	40,012	52,118	16,107	19,088	583,435	674,272
Technical Assistance	–	85	11	5	182	265

Source : Central Bank of Sri Lanka

(a) Excluding IMF financial assistance and Loans to the Department of Railway.

(b) Difference with actual repayment data is due to cross exchange rate variations.

(c) Provisional

External Debt

Detailed information on Sri Lanka's foreign debt are shown in Tables II-21 and II-22.

TABLE II – 22

Maturity, Interest Rates & Grant Element of External debt

Donor Category	Maturity Period (years)		Interest Rate/ Service Charge (% p.a.)	Grant Element (%)
	Grace Period	Repayment Period		
Bilateral	1-16	2-40	0.00-5.68	10-91
Multilateral	1-11	1-40	0.75-2.50	5-94
Commercial	0-11	2-30	1.42-7.70	1-43
Exports Credit	1-13	4-14	0.00-7.39	11-74

Source : Central Bank of Sri Lanka

The outstanding external debt of the government as at end 2003 amounted to Rs.840.3 billion, showing an increase of Rs.129.8 billion (18 per cent) over end 2002. Of the total outstanding external debt as at end 2003, bilateral loans and multilateral loans amounted to Rs.398.8 billion (47 per cent) and Rs.405.0 billion (48 per cent), respectively, while commercial loans and export credit amounted to Rs.36.4 billion (4 per cent). Major creditors in the bilateral loan category were Japan, USA and Germany, accounting for Rs.373.6 billion or 94 per cent of total bilateral loans. The International Development Association (IDA), which is the largest creditor in the multilateral loan category, was responsible for Rs.199.8 billion or 49 per cent of the total multilateral loan.

When classified by the use of funds, project, programme and commodity loans amounted to Rs.674.3 billion (80 per cent), Rs.94.7 billion (11 per cent) and Rs.30.7 billion (4 per cent), respectively.

The repayment of principal and payment of interest plus other charges (including capitalised interest) on external government debt in 2003 were Rs.25.4 billion and Rs.13.8 billion, respectively. Total disbursements during 2003 amounted to Rs.87.5 billion and this consisted of Rs.41.1 billion (47 per cent) from multilateral sources and Rs.29.8 billion (34 per cent) from bilateral sources. Commercial loans and export credit amounted to Rs.16.6 billion. Project and programme loans accounted for 97 per cent of the total disbursements in 2003.

During 2003, 23 new foreign loans were contracted and consequently the number of operative loans increased to 564 by end of 2003. As shown in Table II-22, these foreign loans carried grace periods ranging from 1 - 16 years and repayment periods ranging from 1- 40 years. Interest rates of these loans ranged from 0 to 7.7 per cent per annum. The grant element of the loans ranged between 1 to 94 per cent.

Infrastructure Development and Technical Assistance

In 2003, several pioneering steps were taken by PDD to further develop the government debt securities market. These initiatives included the work relating to the installation of the proposed Scripless Securities Settlement System (SSSS) and Central Depository System (CDS) for Treasury bills and Treasury bonds, conducting seminars, workshops and public awareness programmes on government debt securities market, adoption of a Code of Conduct for PDs, introducing the Bloomberg trading platform, initiating the process to obtain a sovereign credit rating and developing a long term yield curve. Steps were also taken to strengthen the regulatory framework for PDs.

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

PDD continued to work on the completion of the installation of SSSS and CDS during 2003. As a result of this innovation, Treasury bills and Treasury bonds that are hitherto issued in the form of paper certificates will be issued in scripless form. SSSS will improve efficiency in the government debt securities market by enhancing secondary market trading and eliminating the risks associated with paper based securities. Since SSSS operates electronically, on-line trading will be convenient to all market participants. The funds transfer underlying the securities transactions are based on a Real Time Gross Settlement (RTGS) System through which payments will be effected instantaneously on a real time basis.

An important component of the proposed SSSS will be a CDS for government securities. CDS is an electronic database, which will record the holdings of government securities. CDS will perform as the registry as well as the custodian for government securities. SSSS and CDS together will be named 'LankaSecure'.

With the proposed installation of SSSS and CDS in early 2004, PDD will have to manage the transition from scrip securities to scripless securities. Necessary amendments to the relevant legislations to enable the issue and trading of scripless securities as well as dematerialisation of the existing scrip securities were enacted in 2003.

Seminars and Workshops

During the last few years the government debt securities market has grown in many respects. New financial instruments including derivatives such as interest rate swaps and forward rate agreements and international best practices based on state of the art technology have been introduced. In the light of these developments, it was considered important to develop the skills of the CBSL officers and staff of market participants. Accordingly, in 2003, CBSL jointly with the Association of Primary Dealers organised two workshops on fixed income

securities in association with Euromoney Institute of the United Kingdom.

PDD conducted a series of seminars for PDs and other stakeholders of the debt market to finalise the Code of Conduct for PDs. PDD also conducted several public awareness programmes on the proposed SSSS with assistance from PDs.

Code of Conduct for Primary Dealers

The 'Code of Conduct for Primary Dealers' issued in July 2003 has set out guidelines, among other things, on the best practices in areas such as personal dealing by directors and employees of PDs, confidentiality, honesty and fairness, diligence, conflict of interest. The Code came into effect from 1 September 2003. Compliance officers were appointed in PD companies and licensed commercial banks operating primary dealer units to report on the compliance with the provisions of the Code.

Risk Based Capital Adequacy for Primary Dealers

Under the World Bank technical assistance programme, initiatives were taken to develop a risk sensitive capital adequacy framework to promote the financial soundness of PDs and to protect the stability of the financial system. The proposed risk based capital adequacy framework will replace the comprehensive approach to risk assessment of PDs used by PDD at present.

Bloomberg Bond Trading System

PDD took the initiative to introduce the Bloomberg Bond Trading System for the PDs in order to provide basic market infrastructure necessary for trading in government securities. This system will provide real time trading in government securities, resulting in a reduction in trade execution time and transaction cost as well as increased trading volumes and liquidity. Since this system displays firm and competitive two-way quotes from PDs, margins (spreads) between buying and selling prices will be thinner and this will facilitate transparent and efficient price discovery. This system will be directly interfaced with RTGS and SSSS being operated by the Central Bank.

Sovereign Credit Rating for Sri Lanka

CBSL, on behalf of the government, initiated the process to obtain a sovereign credit rating for Sri Lanka in order to establish a benchmark in the international capital market. Sovereign credit rating is an independent assessment of a government's creditworthiness. As an initial step, investment banks operating in Sri Lanka with credit rating advisory services were requested to make proposals to consider appointment of a rating advisor. The rating advisor will assist the government in the rating process to obtain a rating from one or more other international rating agencies.

Regulation and Supervision of the Primary Dealer System

The existing PD system, which was established in March 2000, was expanded in 2002. To enable this expansion, the regulations issued under the LTBO and RSSO were amended permitting LCBs to apply to be appointed as PDs. The expansion was brought about to promote a greater competition among PDs and infuse a higher liquidity into the market. There were eleven PDs operating by the end of 2003 and this included eight PD companies and three LCBs.

Directions were issued under LTBO and RSSO in 2003 to strengthen the framework for the supervision of PDs, particularly with respect to capital requirements and to widen the areas in which prudential requirements such as fiduciary responsibilities and custodial arrangements, standards of competence for the board of directors and senior management, risk management systems and infrastructure can be specified and enforced.

Directions issued to PDs were on minimum capital requirement, Forward Rate Agreements (FRA) and interest rate swaps (IRS), firm two way quotes (bid and offer prices) for benchmark maturities, Special Risk Reserves, Custodial & Trust Holdings of Scrip Securities, minimum subscription levels for Treasury Bill and Treasury Bond Auctions and accounting for Repo transactions. In terms of the direction on minimum capital requirement, PDs are required to increase their minimum capital to Rs.350 million from 31 December 2004 and to Rs.400 million from 1 July 2005. In terms of this direction, from 1 April 2003 PDs were required to maintain a capital adequacy ratio (CAR) of 5 per cent, which was 3 per cent earlier.

A direction on FRA and IRS was issued in April 2003. Financial derivatives such as FRAs and IRSs are useful for managing interest rate risks. In terms of this direction, PDs are required to maintain an additional capital of 12 per cent of risk weighted assets (RWA).

Direction on firm two-way quotes (bid and offer prices) for benchmark maturities was issued in July 2003 to promote the liquidity of medium and long-term instruments. PDD also issued a direction on Special Risk Reserve to promote safety, soundness and stability of the PD system and to build the PD capital base. This direction will be effective from 1 July 2004.

Secondary Market Transactions of Primary Dealers

Secondary market transactions involving outright purchases and sales, repurchases and reverse repurchases on Treasury bills and Treasury bonds have shown a significant increase in both volume and value in 2003. Based on the information compiled through the PD weekly reporting system where a PD is one party to the transaction, total outright sales and purchases of Treasury bills by PDs in the secondary market amounted to Rs.265,757 million and Rs.37,408 million respectively, while

outright sales and purchases of Treasury bonds by PDs amounted to Rs.426,865 million and Rs.349,801 million, respectively. The repo and reverse repo transactions of Treasury bills amounted to Rs.1,058,459 million and Rs.240,911 million, respectively while the repo and reverse repo transactions of Treasury bonds amounted to Rs.1,938,581 million and Rs.304,995 million, respectively.

PDD compiled market reports on a daily as well as a weekly basis on secondary market activities based on returns submitted by PDs. The reports provided aggregate data on trading volumes and yield rates by maturity for outright and repurchase transactions. The reports also included weighted average market prices and average two-way quotes for Treasury bills and Treasury bonds of different maturities.

Regional Development

The Regional Development Department (RDD) played an important role in developing and implementing policies and programmes with a view to strengthening the small and medium and microfinance sectors in the country. It continued to provide refinance under various donor funded credit programmes and administer the credit guarantee schemes applicable to some credit programmes. Further the RDD continued to implement the Small Farmers and the Landless Credit Project (SFLCP) and the Poverty Alleviation Microfinance Project (PAMP) aimed at poverty alleviation in ten selected districts. The department also carried out project inspections and the follow-up work in respect of on-going and concluded credit schemes. The department was also involved in monitoring the activities of the Regional Development Banks (RDBs) and providing guidance with a view to building their capacity as rural financing institutions. Further, the department assisted in the preparation of the Rural Finance Sector Development Project designed to contribute to economic growth and poverty reduction by establishing a sustainable rural finance system through policy adjustments and improving the capacity and operations of the rural finance institutions. This project will be funded by the Asian Development Bank (ADB) and implemented in 2004.

Progress of the Credit Schemes

The credit schemes handled by the department in 2003 can be broadly categorised according to the source of funding.

A. Donor Funded Projects

(a) ADB Funded Projects

- (i) Tea Development Project
- (ii) Second Perennial Crop Development Project
- (iii) Skills Development Project
- (iv) Urban Development and Low Income Housing sector Project and
- (v) North Central Province Rural Development Project

(b) Other Donor Funded Projects

- (i) North Central Province Participatory Rural Development Project (IFAD, SIDA, WEP)
- (ii) Poverty Alleviation Micro-finance Project (JBIC)
- (iii) Matale Regional Economic Advancement Project (IFAD)

B. Government Sponsored Programmes

* Interest Subsidy

- (i) New Comprehensive Rural Credit Scheme including Forward Sales Contract System (NCRCS)
- (ii) Surathura Credit Scheme.

* Revolving Funds

- (i) Small Farmers and the Landless Credit Project (ISURU)
- (ii) Sabaragamuwa Province Integrated Rural Development Project (SPIRD)
- (iii) Urban Environmental Infrastructure Development Project (Revolving Fund) Credit Scheme
- (iv) Southern Province Rural Development (Revolving Fund) Credit Scheme

Tea Development Project (TDP)

The TDP funded by the ADB, which commenced its operations in 1999 as a follow up to the Small Holder Tea Development Project which was concluded in 1997, completed its fourth year of operation in 2003. The project covers all tea growing districts and is scheduled to be completed by 2005. The objectives of the project are to increase tea small holders' income on a sustainable basis and to improve the environment in the project area. The Central Bank is the executing agency of the credit component of the project. Under the Project, credit is provided for replanting of tea, establishment of tea nurseries, rehabilitation and modernisation of tea factories, purchase of vehicles and construction of green leaf collection centres.

The allocation for the credit component is equal to US dollars 28.1 million (approximately Rs.2,600 million). Out of the allocation, a sum of Rs.2,373 million has been approved to 4,162 eligible sub projects and Rs.2,059 million has been disbursed to 3,974 sub projects by all Participating Financial Institutions (PFIs) as at the end 2003. Upto the end of 2003, the Central Bank had granted refinance facilities to PFIs to the tune of Rs.1,560 million in respect of 3,388 sub loans.

During the first half of the year, the demand for loans from the tea small holders remained low due to the unfavourable weather conditions in tea growing districts and the heavy floods in low grown tea areas. Although the loan demand improved during the latter part of the year, the PFIs were unable to achieve loan disbursement targets set for the year. They disbursed a total sum of Rs.434.0 million in 2003, which was 72 per cent of the target for the year.

Second Perennial Crops Development Project (SPCDP)

The objective of the scheme was to support the development and commercialisation of the Perennial Crop sector (Fruit Crops, Spice Crop, Flowers and Foliage) and institute measures to ensure sustainability of credit facilities and extension services for the Perennial Crop sector by providing credit facilities and support services. The project completed its 5th year of operation in 2003 and is scheduled to be completed in 2005. The Central Bank is the executing agency for the credit component, and the project management office (PMO) is responsible for implementing the other components *i.e.*, research, seed and planting materials, farm advisory, marketing and technical services and institutional strengthening, on behalf of the Ministry of Agriculture.

Out of the total ADB allocation of SDR 14.743 million, SDR 11.562 million has been set apart as the credit component from which refinance is provided to PFIs. The PFIs of the scheme include the National Development Bank, the DFCC Bank, the Hatton National Bank, the Commercial Bank, the Sampath Bank, the Bank of Ceylon, the Kandurata Development Bank and the Ruhuna Development Bank. The project is operational in seventeen districts. As at end 2003, a sum of Rs.1,497 million has been disbursed to 4,390 eligible sub projects by all PFIs. The amount disbursed by PFIs during the year stood at Rs.571 million which is the amount targeted for the year. The Central Bank had granted a sum of Rs.353 million as refinance on claims submitted by the PFIs.

Skills Development Project (SDP)

The Skills Development Project (SDP) funded by the ADB came into effect in 1999. Under the project agreement, a loan of SDR 13.7 million has been provided by the ADB to the government for financing the project. Out of the total allocation, a sum of US dollars 675,000 has been allocated for the credit component to provide refinance in respect of loans granted for the establishment of small scale entrepreneurial or self employment activities. The Ministry of Tertiary Education and Training (MOTET) is responsible for implementing the overall project over a period of six years from March 2000 to August 2006. On a request made by MOTET, the Central Bank undertook the responsibility of providing refinance in respect of sub loans granted to eligible borrowers who successfully complete the Skills Development Programmes conducted by the Ministry. The selected trainees will undergo further entrepreneurial training conducted by the Ministry before being considered for granting loans. The maximum loan size would be Rs.250,000 per borrower. The lending operations commenced during the latter part of 2003.

Six Regional Development Banks, Bank of Ceylon, People's Bank, Hatton National Bank and Seylan Bank are the Participating Credit Institutions (PCIs) implementing the credit

component. The on-lending rate is 10 per cent per annum. The Ruhuna Development Bank had disbursed 18 loans under the project as at end 2003.

Urban Development & Low Income Housing Sector Project (UDLIHSP)

The UDLIHSP commenced its operations in 1999 with financial assistance in the form of a loan of US dollars 20 million from the ADB. This project is scheduled to be closed in 2004. The loan approvals and the refinance disbursements of the project decreased slightly during 2003 compared with the year 2002, due to the relatively higher loan interest rates under the project compared to the market rates during the 1st half of 2003 and the suspension of participation of four PCIs by the ADB due to the poor performance as indicated by their financial ratios in 2002. However, during latter part of 2003, the progress of the loan scheme improved with the reduction of on-lending interest rates by PCIs by about 2 to 3 percentage points from 1st July 2003 and the readmission of the four PCIs which had been suspended.

Total loan approvals during the year under the project amounted to Rs.576.1 million and total refinance disbursements amounted to Rs.358.0 million. Total refinance disbursements did not increase in line with the loan approvals due to the release of loans in instalments and because refinance is released on the basis of release of loans. The Housing Development Finance Corporation, the major partner of the loan scheme, accounted for 60 per cent of the loans approved amounting to Rs.344.7 million.

Out of the total number of loans of 7,659 granted to sub borrowers, more than 93 per cent were for the purpose of construction of new houses and extensions to existing houses. The balance was for purposes such as land acquisition, and purchase of houses.

North Central Province - Rural Development Project (NCP-RDP)

ADB funded NCP-RDP is an integrated rural development project aimed at reducing poverty in the North Central Province. The project area covers the Mahaweli settlements in the Anuradhapura District and the entire Polonnaruwa District. The project commenced in 1997 and was scheduled to be completed by end 2003. However, the project period was extended until 30th June 2004 for the settlement of expenditure on project activities, which had not been completed by the end of 2003.

The Central Bank is the executing agency for the credit component of the Project. The objective of the credit component is to assist a wide range of farm and non-farm enterprises by granting credit through the PCIs. The four PCIs are Bank of Ceylon, People's Bank, Hatton National Bank and the Seylan Bank. The ADB allocated a sum of US dollars

500,000 (approximately Rs.40 Million) in 2001 to provide refinance to PCIs. The credit limit per borrower is Rs.250,000.

Under the project, provision of support services has been contracted out to two private sector suppliers; namely the Industrial Services Bureau (ISB) and the Seva Lanka Foundation (SLF). During the year, loans amounting to Rs.19.2 million had been disbursed by the PCIs, bringing the total amount disbursed to Rs.21 million by the end of 2003. Total refinance to the PCIs at the end of 2003 amounted to Rs.15.9 million, accounting for 40 per cent of the total allocation for refinance under the Project.

North Central Province Participatory Rural Development Project (NCP-PRDP)

The International Fund for Agricultural Development (IFAD) funded the NCP-PRDP project. This project is also an integrated rural development project aimed at poverty reduction with balanced regional development. The project area covers the Anuradhapura District, excluding the Mahaweli settlements. The Project commenced in 1996 and was scheduled to be completed by end 2002. However, the period was extended by one year. The Project was successfully completed by the end of 2003.

The Central Bank was the executing agency for the credit component of the Project. In 2003, the Bank released a sum of Rs.14.1 Million to the PCIs as refinance loans, bringing the total refinancing to Rs.19 million. By the end of 2003, the total amount allocated for refinance had been fully utilised.

Poverty Alleviation Microfinance Project (PAMP) – JBIC

The PAMP, funded by the Japan Bank for International Co-operation (JBIC), is a replication of the SFLCP. The Japanese government, in recognition of the satisfactory achievements of SFLCP decided to fund the PAMP as a microfinance intervention to alleviate poverty in six other districts, namely Kalutara, Hambantota, Badulla, Nuwara Eliya, Matale, and Kurunegala. The Project envisages a cost effective and sustainable micro credit delivery system, high women participation, inculcating savings habits and thrift among poor, improving the literacy level of the rural community and improving self confidence and weaning them away from the dependency mentality.

Although the foreign funding from JBIC is to terminate by end 2006, the project will continue for a further twenty years by utilising the funds accumulated in the Revolving Fund from loan recoveries and interest income earned on balances invested.

In 2003, the project progressed satisfactorily and had recognised 8,597 SHGs with 46,536 beneficiaries. Micro loans

granted under the project amounted to Rs.290.7 million with the volume of savings collected through group savings amounting to Rs.54.5 million. The number of villages covered by the project was 3,541 and the women participation was at 76 per cent. The cumulative recovery rate of the loans stood at 98 per cent. In 2003, initiatives were taken to expand the project to the districts in the North and the East. It is expected that implementation of the project in these districts will commence in 2004. The computerisation of project accounts at district level was completed during the year.

Matale Regional Economic Advancement Project (M-REAP)

The M-REAP came into effect in 1999. The project aims at raising and sustaining the income levels of the rural families in the project area on a permanent basis. The implementation of the credit component of the project began two years later in 2001. The Central Bank functions as the executing agency of the rural financing component of the project. The IFAD has allocated SDR 8.35 million for the entire project, of which SDR 2 million has been allocated to extend refinance facilities to the PCIs in respect of loans granted by them under the project for productive income generating activities.

Private sector involvement is a significant feature of the project. The participation of the private sector is encouraged by involving civil groups in the project. With a view to increasing the demand for credit, the PCIs reduced the loan interest rates from 14 per cent to 12 per cent per annum in line with trends in market interest rates.

During the year under review, PCIs disbursed Rs.49.8 million as targeted and the cumulative loan disbursement stood at Rs.122 million as at end 2003. The Central Bank has granted Rs.98.5 million to the PCIs as refinance from project funds.

New Comprehensive Rural Credit Scheme (NCRCS)

The NCRCS was implemented throughout the country during the year under review for providing short term cultivation loans for paddy and other subsidiary food crops. Loans were also provided for purchase of these crops under the Forward Sales Contract System. The interest rate on these loans was reduced from 12 per cent per annum to 8 per cent per annum in 2003. The total loans provided for cultivation purposes amounted to Rs.443 million in 2002/2003 Maha season and Rs.492.6 million in Yala, 2003. The amounts granted on loans for purchase of agricultural produce under the scheme were Rs.335.8 million and Rs.377.3 million during Maha and Yala seasons respectively. The government paid Rs.63.6 million as interest subsidy to the lending banks under the NCRCS. A sum of Rs.77.8 million was paid as credit guarantee indemnity against the defaulted cultivation loans during 1994 - 1998.

TABLE II – 23
Credit Schemes Operated by the Regional Development Department during 2003

	Name of the Project	Funding Agency	Broad Mission	Original Allocation	Annual Interest Rate to the Borrowers	Credit Disbursement in 2003 (Rs. mn.)	Recovery Rate where applicable %
1.	Tea Development Project (1999-2005)	ADB	Increase tea small holders income on a sustainable basis and to improve the natural environment in the project area.	US \$ 24.45 mn.*	On the basis of AWDR ** 8.5 - 10.5% (for Field Development) AWDR + 6% (for Factory Development)	2,059	91
2.	Second Perennial Crops Development Project (1998-2004)	ADB	Increase the production and commercialisation of Perennial Crops, development of nurseries, post-harvest handling and processing activities and marketing.	SDR 11.562 mn.	On the basis of AWDR 8.5 - 10.5% per annum	1,497	92
3.	Skills Development Project (Year commenced 2000)	ADB	Improve quality and relevance of skill training programmes to build a high quality workforce and address issue of skills mismatch and unemployment among rural and urban youth.	SDR 0.657 mn.	10%	–	Not commencement yet
4.	North-Central Province Participatory Rural Development Project (1996-2002) North-Central Province Rural Development Project (1997-2003)	ADB, IFAD, SIDA and WFP	Poverty alleviation, improves food security, nutrition and increase employment opportunities for low-income families.	SL Rs. 153 mn. SL Rs. 43 mn.	AWDR or 10% whichever is lower + 6 percentage points	19 21	90 90
5.	Urban Environmental Infrastructure Development Project - Phase II (Revolving Fund)	USAID	Improve environmental facilities, health & sanitary conditions of the people living in urban and semi-urban areas.	SL Rs. 100 mn.	16%	4	100
6.	Poverty Alleviation Micro-finance Project (Year commenced 2000)	JBIC	To establish a cost effective and sustainable micro-credit delivery system to generate employment and improve savings habits.	¥ 1,368 mn.	18%	290.7	98
7.	Matale Regional Economic Advancement Project (2000-2006)	IFAD	Permanent raising and sustaining of income of small entrepreneurs of rural and farmer families of project area.	SDR 2 mn.	12%	122	95
8.	New Comprehensive Rural Credit Scheme	PCIs with govt. interest subsidy	Upliftment of rural farmers who cultivate short-term food crops.	–	8%	935.6	n.a.
9.	Small Farmers & Landless Credit Project (1990-2000)	IFAD, CIDA, and GOSL	To establish a cost effective and sustainable micro-credit delivery system to generate employment and improve savings habits.	SDR 4.85 mn.	Market Rates Agri. – 16% Other Purposes – 20%	1,109.6	97
10.	Kegalle District Integrated Rural Development (Revolving Fund) Project (1997-2007)	Govt. of Sri Lanka	Uplift the standard of living of the people in the project area by promoting income-generating activities.	SL Rs. 100 mn.	10%	327.9	94
11.	Surathura Programme Phase II (1998 onwards)	PCIs with govt. interest subsidy	Increasing income and improving living standards of unemployed educated youth by promoting self-employment among them.	SLRs 1,300 mn.	10%	21	50
12.	Southern Province Rural Development (Revolving Fund) Project (from 2000)	– do –	To improve the quality of life of the people in the Southern Province.	US \$ 8.1 mn.	12%	41	90
13.	Urban Development and Low Income Housing Project (credit component)	ADB	To provide depical to support lending to low income household groups for housing improvements	US \$ 20 mn.	11.91%	1,668	n.a.

* Allocation of ADB Funds

** AWDR – Average Weighted Deposit Rate

JBIC – Japanese Bank for International Co-operation

Suratura Programme – Self Employment Promotion through Micro Enterprise Credit

The three PCIs of the Suratura Programme, Bank of Ceylon (BOC), People's Bank (PB) and Hatton National Bank (HNB), continued to extend credit under the Second Phase of the programme out of their own funds at a subsidised interest rate of 10 per cent per annum. The government continued to pay a 10 per cent interest subsidy to PCIs under the scheme.

Under Phase II of the project, which commenced in 1997, 30,000 loans to the value of Rs.1,300 million were targeted for disbursement by the PCIs to eligible borrowers to undertake income generating self employment activities. The scheme provided loans to unemployed, particularly the educated youth, to enable them to commence new projects or to expand existing projects. The Central Bank was entrusted with the responsibility of operating the interest subsidy component and monitoring the recoveries. The government paid PCIs Rs.18 million as interest subsidy in 2003.

Small Farmers and the Landless Credit Project (SFLCP)

The SFLCP introduced in 1990, was jointly funded by the International Fund for Agricultural Development (IFAD) – a loan of US dollars 6.7 million, Canadian International Development Agency (CIDA) – a grant of US dollars 6.6 million and the Government (Central Bank) – a contribution equivalent to US dollars 4.1 million. The target group of the project is poor persons who belong to households earning less than Rs.3,000 per month and who have no access to financial services from formal banking institutions. The project is implemented in four districts, namely Galle, Matara, Puttalam and Kandy.

In granting credit under the project, the provision of "credit plus" services is emphasised. Financial services are provided by the Regional Development Banks (RDBs) and the grassroots level organisations enrolled as Participating Agencies (PAs) under the project. The group approach adopted in the operation of the project is helpful in loan monitoring, follow up, recovery and introducing new technology. The SFLCP, dubbed as 'ISURU', is a cost effective credit delivery system at village level. The Central Bank implements the project through a Central Project Office located in the Central Bank's Head Office and through project district offices (PDOs) located in the project districts. The RDBs act as bankers to the project. Foreign funding for the project was terminated in December 1997 as originally scheduled. The project was continued, however, thereafter by using funds in a Revolving Fund.

As at end 2003, the project was in operation in 4,123 villages in the four districts. There were 15,175 Self-Help Groups (SHGs) with 89,189 beneficiaries. This figure was well above the target of 32,000 set in the original project design.

The most striking feature of the project was the high participation of women in project activities, numbering 64,077 or 72 per cent of the total number of beneficiaries. As at end 2003, a sum of Rs.1,109.6 million had been advanced as micro loans to the borrowers to undertake income generating self-employment activities. The average size of a loan was Rs.12,606. The project has consistently maintained a high cumulative recovery rate of over 97 percent. In addition, the beneficiaries had saved Rs.193.1 million as compulsory and voluntary group savings as at end 2003.

The SHGs were amalgamated in 1997 to form village level ISURU Development Societies (IDSs), as formal corporate bodies, to strengthen the fund base, improve negotiation capacity and enhance synergical power. The village level IDS are amalgamated into four district level IDSs. In 2003, action was taken to form the National Isuru Federation by amalgamating district level IDSs.

'National Isuru Federation' comprises representatives from district level IDSs. The federation is expected to be a strong national level forum of ISURU beneficiaries that would ensure the long term sustainability of the project. The federation conducted its first national convention and a trade fair of ISURU products under the guidance and supervision of Isuru Project District offices and the Central Project Office. The objective of conducting the trade fair was to introduce products of ISURU beneficiaries to the formal market and to develop necessary linkages.

Sabaragamuwa Province Integrated Rural Development (Revolving Fund) Project (SPIRDP)

SPIRDP is an extension of the Kegalle District Integrated Rural Development Project (KGIRD), which was implemented in the Kegalle District with financial assistance from IFAD from 1986 to 1996. The credit component of the project was implemented through the People's Bank, the Bank of Ceylon and the then Kegalle Regional Rural Development Bank (RRDB). The Central Bank was responsible for providing refinance in respect of development loans granted by PCIs to low income groups, enterprises and youth. After completion of the project, the Central Bank established and maintained a revolving fund out of recoveries of refinance loans in order to continue credit programmes.

The PCIs are assisted in the delivery of credit at grassroots level by Business Development Officers (BDOs) who function under the Project Management Unit. They identify the eligible borrowers and prepare business development plans, and finally direct them to the PCIs for obtaining credit. This arrangement helped the PCIs in efficient delivery of credit and recovery.

Having considered the high demand for credit, KGIRD Revolving Fund was extended in 2002 to the Ratnapura District, bringing the entire Sabaragamuwa Province under the project. The project was re-named as the Sabaragamuwa Province

Integrated Rural Development Project (SPIRD) Revolving Fund Credit Scheme. A sum of Rs.25 million was allocated initially for providing refinance in the Ratnapura District.

The project had financed 8,112 sub-projects worth of Rs.327.91 million as at end 2003. The loans granted by the PCIs during 2003 amounted to Rs.82.71 million. The project had financed 1925 sub-projects and 4,789 self-employment opportunities during the year 2003. The overall recovery rate of the project loans was 94 per cent as at end 2003.

Urban Environmental Infrastructure Development Project (UEIDP) (Phase II – Revolving Fund Credit Scheme)

The UEIDP phase II, Revolving Fund Credit Scheme was introduced in May 2002 to continue with the credit activities of the UEIDP (Phase I). Total allocation of funds for the Revolving Funds-Phase II was Rs.100 million, and the credit programme was successfully completed in March 2003. The number of loans granted under the project was 875, and these loans have been granted for the purposes of water supply and sanitation, garbage disposal, waste water management and drainage.

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

Implementation of the Second Revolving Fund Credit Scheme of the Southern Province Rural Development Project (SPRDP)

commenced in 2003 with an allocation of Rs 200 million for refinance to Participatory Credit Institutions (PCIs), i.e. Ruhuna Development Bank, DFCC Bank, and the National Development Bank. The Revolving Fund Credit Scheme is intended to continue the credit activities of the ADB Funded Southern Province Rural Development Project, which was completed in 2000 and the first SPRDP Revolving fund Credit Scheme completed in 2002. Under these Programmes, credit facilities were made available through the PCIs for the development of rural micro, small and medium scale industries in the Southern Province to improve the economic conditions of the people and to create employment opportunities.

During the year under review, the Central Bank issued Rs.41 million to the PCIs as refinance for loans granted by them under the first Revolving Fund Credit Scheme.

Credit Guarantee Schemes under Small and Medium Scale enterprises (SMI & SMAP)

Credit Guarantee Schemes:

In accordance with Section 108(1) of the Monetary Law Act, the Central Bank (CBSL) acts as the agent of the Government or acts on behalf of the Government, in guaranteeing the loans granted by banking institutions, which are qualified to receive guarantees under special loan schemes. An amendment was made to the Monetary Law Act in 1974 by which a new Section 108A was introduced to extend guarantees to loans, advances

TABLE II – 24
Details of Credit Guarantee Schemes and Claim Settlement Position as at 31-12-2003

Name of the Credit Scheme	No. of Loans Granted	Loan Amount (Rs. Mn.)	Premia Collected during the year (Rs. '000)	No. of Claims Received	No. of Claims Settled	Amount Settled (Rs. '000)	Post Claim Recoveries (Rs. '000)
New Comprehensive Rural Credit Scheme (a)	43,862	722	5,871	n.a.	n.a.	146,225	442
Tea Development Project (b)	1,647	639	11,913	1	0	0	0
Second Perennial Crop Development Project Credit Scheme (c)	1,510	860	12,991	3	1	634	0
Small Holder Tea Development Project	6,638	609	493	19	19	225	53
Mid Country Perennial Crop Development Project	5,734	737	656	478	478	16,633	0
Agriculture Rehabilitation Project	12,896	710	320	715	447	8,456	30
Plantation Sector Reform Project	224	4,953	75,511	1	0	0	
BPL Credit Gua-rantee Scherme	1,932	1,099	0	20	11	2,185	1,887
SMAP Credit Guarantee Scheme (b)	1,894	2,742	3,719	102	16	12,483	1,732
SMI Credit Guarantee Schemes (b)							
SMI I	1,970	286		335	261	22,207	8,830
SMI II	2,351	1,397		228	131	29,435	18,758
SMI III	3,130	1,956		172	92	24,066	19,222
SMI IV	9,072	7,666		311	96	39,810	13,827
Sub Total (SMI I, II, III & IV Schemes)	16,523	11,305	2,211	1046	580	115,518	60,637
Grand Total	92,860	24,376	113,685	2,385	1,552	302,359	64,781

(a) From 1994 Yala to 1997/98 Maha (loan amount excluding HNB Bank)

Source : Regional Development Department

(b) On-going project, loans granted for replanting and Nursery Operation only

(c) On-going project

or other accommodation granted to small-scale enterprises by credit institutions operating in Sri Lanka. This provision has facilitated the CBSL to operate guarantee schemes on account of loans granted by PCIs to small enterprises and for agricultural activities.

The Regional Development Department is, at present, implementing ten credit guarantee schemes as given in Table II- 24 Premia are collected annually in respect of all these credit schemes at different rates. Out of the 10 credit guarantee schemes, the Central Bank has a direct exposure for settlement of claims in respect of seven credit guarantee schemes. In respect of the other three schemes [New Comprehensive Rural Credit Scheme (NCRCS), Tea Development Project Credit Scheme (TDP), Second Perennial Crops Development Credit Scheme (SPCDP)], the government has provided the funds. The liability of credit guarantee on the loans granted under these three schemes will be discharged by the CBSL, out of the funds received periodically from the government budgetary allocations, and funds generated by way of premia and investment income. Credit guarantee claims of the PCIs in respect of loans in default will be entertained by the CBSL only after the PCIs have initiated legal action against the borrower to recover the loan. After the settlement of a claim, any money recovered by the PCI thereafter in respect of the loan is to be shared with the CBSL.

There are three major sources of funds for credit guarantee schemes.

- (a) Premia Collection;
- (b) Central Bank and Government Contribution; and
- (c) Income on investment of funds.

The total credit guarantee exposure of the Central Bank under the eight Credit Guarantee Schemes as at 31.12.2003 is Rs.4,014.6 million.

Regional Offices

Regional Office (RO), Matara

The RO, Matara, as in the past, continued to implement programmes to promote rural economic development and to supervise agricultural and rural credit functions in the region. Apart from these development credit activities, the RO assisted the CBSL in the collection of statistics and information in the region. Other central banking functions such as provision of regional cheque clearing facilities, assisting financial institutions, government departments and NGOs on development lending, entrepreneurship development, educational training, banking and other related fields were also carried out.

Development Banking activities included the co-ordination of microfinance and development credit schemes namely; Small Farmers and the Landless Credit Project (SFLCP) in Galle and Matara Districts and Poverty Alleviation and Microfinance

Project (PAMP) in Hambantota District, Forward Sales Contract Scheme (FSCS), Arunalu Village Adoption Programme, Small Holder Tea Development Project (SHTDP) Credit Scheme, Second Perennial Crop Development Credit Scheme (SPCDP), Skills Development Credit Scheme (SDP), Southern Province Rural Development Project (SPRDP) Credit Scheme and Southern Province Regional Economic Advancement Project (SP-REAP) Credit Scheme and Tea Development Project (TDP). With a view to find a sustainable solution to the marketing problems of the farmers, the Forward Sales Contract System (FSCS) was introduced by the Central Bank in 1999. The RO actively promoted this scheme by conducting 16 awareness programmes in Galle, Matara and Hambantota Districts during the year under review.

In addition to the above, the RO worked in association with the Southern Provincial Council and the National Development Bank (NDB) in implementing the Southern Province Rural Economic Advancement Project (SP-REAP). The RO is represented in the Provincial Advisory Committee of the project. The "Sahanaya" credit scheme refinanced by the DFCC with the assistance of the IDB was also assisted by the RO.

Under a new concept introduced by the University of Ruhuna, the Ruhuna Business Incubator (Pvt) Ltd. (RBI) was opened at Kamburupitiya. The RO continued to assist the RBI for selection of entrepreneurs, and the first batch of entrepreneurs has commenced their business at Kamburupitiya during the year 2003.

The RO assisted the Statistics Department of the Central Bank in the implementation of the Island-wide Data Collection Programme, Weekly Data Collection Programme and conducting of the Consumer Finance Survey 2003/04.

Other Central Banking functions, including regional cheque clearing facilities, educational training and sale of Central Bank publications etc., were also performed by the Regional Office during the year 2003.

The Regional Clearing House provides cheque clearing facilities for 10 banks in the area. During the year, through this operation, 1,235,673 cheques to the value of Rs.27,543.9 million had been cleared. A workshop to explore the possibility of expanding the clearing facility to the whole region was conducted with the participation of CBSL, LankaClear (Pvt) Ltd., and commercial banks in December, 2003.

The RO conducted 18 educational seminars for school children on central banking. 675 students and teachers participated in these Seminars.

The RO actively assisted the "Yuga Dekma" Industrial Exhibition organised by the Ministry of Industries in Matara with a view to promoting the marketing of produce by project holders under various credit programmes supported by the Central Bank.

Regional Office, Anuradhapura

During the year under review, the RO of Anuradhapura continued to implement several programmes aimed at economic and social development in the region. The focus of the activities undertaken by the RO was the upliftment of living standards in the rural sector through the financial system. The RO was actively engaged in implementing the North Central Province Rural Development Project (NCP-RDP) and the North Central Province Participatory Rural Development Project (NCP-PRDP). The RO prepared a district data profile for Anuradhapura District. Further, agricultural and entrepreneurship development programmes, collection of test data for the consumer price index were also undertaken by the RO. Regional cheque clearing house activities were continued in 2003. The RO also continued to conduct educational seminars for the benefit of school children.

During the year, 99 awareness programmes were conducted on the forward sales contract system and more than 11,000 persons participated in these programmes. Consequently, 8,858 forward sales agreements were signed with a value of about Rs.488 million for agro produce such as paddy, soya bean, maize and banana. In addition to Anuradhapura and Polonnaruwa districts, forward sales contracts system was promoted in Kurunegala, Trincomalee and Jaffna districts with credit facilities provided under the NCRCS. Further, the training programmes on agro-based enterprises were also carried out and 1,100 farmers, entrepreneurs and housewives participated in the programmes.

In the seminars conducted for the benefit of Advanced Level students and teachers in commerce and economics in the districts of Anuradhapura and Polonnaruwa, over 800 teachers and students participated during the year under review.

The RO continued to provide data and information on retail-wholesale prices of major food items in the Anuradhapura Centre for the use of the Department of Statistics of the Central Bank. The service of checking balances of members of the Employees Provident Fund and issuing statements to members was continued. Through the Regional Clearing House, 224,681 cheques to the value of Rs.8,086 million were cleared.

Failed projects under the NCP-PRDP and NCP-RDP were identified and steps were taken to assist the project holders to rehabilitate projects. By the end of 2003, the two projects (NCP-RDP and NCP-PRDP) were able to grant loans to 719 borrowers to the value of Rs.47.53 million.

The RO also actively participated in economic, social and cultural development activities implemented by the North Central Provincial Council and the Central Government throughout the year.

Regional Office, Matale

The RO, Matale was actively engaged in rural development sector activities i.e., implementation of refinance schemes and other regional level development programmes, popularisation

of the Forward Sales Contracts System (FSCS), conducting training programmes for the benefit of entrepreneurs, conducting of educational seminars and workshops for target groups. Further, a number of meetings with farmers and buyers under the FSCS were conducted jointly with the Kandurata Development Bank. A seminar on Improvement of Regional Cheque Clearing system to cover the Central Province and the district of Kegalle was conducted. A familiarisation programme on the Real Time Gross Settlement System (RTGS) was also conducted for officers of commercial banks in the area.

In addition to the above, educational programmes on identifying forged currency notes, and usage of clean currency notes and awareness meetings on registered finance companies were conducted. Under the Tree Planting programme launched by the CBSL, distribution of plants to schools to promote environmental protection was also carried out during the year under review.

During the year, the RO arranged 18 seminars and workshops and organised trade fairs for promoting sale of products by small producers. The RO assisted the Statistics Department of the Central Bank in the Collection of data and continued with the cheque clearing function and sale of Central Bank publications in the year 2003.

The RO facilitated 2,807 Forward Sales Agreements in respect of Paddy, Big Onion, Soya, Kurakkan, Ground Nuts, Turmeric, Maize, Vegetable, Fruit and Milk. These agreements covered 4.31 million kg. of Paddy, 2.75 million kg. of Big Onion and 0.39 million kg. of other products. The total volume of agricultural produce covered under FSCS amounted to 7.45 million kgs.

The RO, Matale also actively participated in the implementation of the Matale Regional Economic Advancement Project (M-REAP) and 1,316 beneficiaries had been registered under the project and loans to the value of Rs.67.72 million were recommended for refinance facilities during the year 2003. The Regional Office also assisted the Project Offices of the Poverty Alleviation Microfinance Project (PAMP) and Small Farmers and the Landless Credit Project (SFLCP) to implement project activities in the districts of Matale, Kandy and Nuwara Eliya.

The RO cleared 808,747 cheques to the value of Rs.35,508 million through its Kandy Clearing House, while the Matale Clearing House cleared 109,541 cheques to the value of Rs.2,161 million during the year.

Regional Development Banks (RDBs)

The RDD continued to monitor the activities of the RDBs with the objective of ensuring their financial and operational viability and assisting them in building their capacity to achieve their objectives as stipulated in the RDBs Act.

The RDBs were established under the Regional Development Banks Act, No.6 of 1997 with the object of providing financial assistance for the development of

agriculture, industry, trade, commerce, fisheries and other development activities within their respective regions with emphasis on financing the poor under poverty alleviation programmes. Six RDBs *i.e.*, Ruhuna, Kadurata, Rajarata, Wayamba, Sabaragamuwa and Uva continued to function covering 18 administrative districts in the country during the year under review. The Central Bank of Sri Lanka (CBSL) was initially the main shareholder of the six RDBs with over 50 per cent of the total issued share capital of each RDB. However, the Central Bank subsequently reduced its shareholding in each RDB to 20 per cent of its share capital by transferring the balance to the government.

The subject of RDBs which was under the Ministry of Finance was transferred to the Ministry of Rural Economy (MRE) with effect from 28th February, 2003. Several credit schemes such as Athamaru, Diriyalanda and Gemira and the Sipsarana savings scheme were introduced by RDBs under the guidance of the MRE in order to improve accessibility to microfinance services by rural and low income householders. The Ministry has also introduced the Production Specialised Village Programme with a view to enhancing the production capacity of people in selected villages with increased use of resources available in those villages.

A large segment of lower and middle income groups live in semi-urban and rural areas in the district of Colombo, and they do not have access to facilities provided by the RDBs. Therefore, in terms of Section 2 of the Regional Development Banks Act, No. 6 of 1997, the administrative district of Colombo was included in the region covered by the Sabaragamuwa Development Bank (SDB) with effect from 15th September, 2003 increasing the total number of districts served by the RDBs to eighteen. The RDD assisted the MRE in matters relating to RDBs.

Research Activities

The Economic Research Department (ERD) discharged its statutory responsibilities of providing information, analyses and advice to the Monetary Board to assist it in the conduct of monetary policy and in fulfilling its role as economic advisor to the government, and or disseminating information on economic matters to the general public.

In order to discharge its responsibilities, the ERD collected, compiled and analysed economic data from domestic and international sources. Measures were taken to improve the dissemination of information, in terms of quality, coverage and timeliness. The technical skills of ERD staff were extensively used by both other departments within the Bank and by outside agencies. Officers were often required to serve as resource persons and technical advisors. The Department also provided policy advice on various issues to other departments within the Bank and to other government institutions, in particular, the Ministry of Finance.

The provision of analyses and information for the determination of monetary policy was an important task of the Department. The Department played a vital role in the functioning of the Monetary Policy Committee. The Department also provided inputs and participated in the deliberations of the Market Operations Committee, the Domestic Debt Management Committee, the Foreign Reserves Management Committee and the Inflation Forecasting Group. In pursuit of the Bank's policy of increasing the transparency of its operations, details of the monetary policy framework and projections, under the monetary programme were posted on the Bank's website. Meetings were held with market participants to inform them of the Bank's monetary policy objectives and projections and thereby to increase market awareness of current economic developments. The ensuing dialogue has helped to enhance market understanding, thereby helping to improve the effectiveness of monetary policy. Background work relating to the Bank's medium-term plan of moving to an inflation-targetting framework was continued, with the assistance of the Riksbank of Sweden.

The Department provided the major inputs for the smooth functioning of the work of the Monetary Policy Committee (MPC). The MPC was formally established in early 2001 to study and make recommendations on monetary policy, through the Governor, for the consideration of the Monetary Board. The need for such a formal committee arose from the fact that the determination and implementation of monetary policy through the Governor, a primary function of the Central Bank, has increased in complexity with the financial sector of the country becoming deeper and more sophisticated. This has also helped in broadening the participation of other relevant departments in the formulation of monetary policy. The MPC meets at least once each month and evaluates economic developments and the monetary policy stance and provides recommendations on monetary policy, through the Governor, for the consideration of the Monetary Board. Background papers and information for these meetings are provided mainly by the ERD, in addition to its officers serving on the MPC. Following the Monetary Board meeting, the Central Bank issues a monthly statement on its monetary policy stance. In order to achieve greater transparency and increase the market awareness of its policies, the Central Bank has issued an advance release calendar approved by the Monetary Board, indicating when the monthly monetary policy statements will be released. These statements carry detailed information on current economic developments, the monetary policy stance and the reasons for the stance. These monthly press releases are prepared by the ERD for the approval of the Monetary Board. Details of the monetary policy framework, monetary projections including the estimation process, and the advance release calendar for the monthly monetary policy stance announcements have been published in the Bank's website (www.centralbank.org).

The ERD co-ordinated Sri Lanka's relations with the International Monetary Fund (IMF), the Inter-Governmental Group of Twenty Four (G-24), the SEACEN Centre for Research and Training, the SEANZA group and the SAARCFINANCE grouping of Central Bank Governors and Finance Secretaries, while assisting the Ministry of Finance in planning and co-ordinating work with the World Bank (WB), the Asian Development Bank (ADB) and other multilateral and bilateral donors. The ERD was primarily responsible for co-ordinating work relating to the finalisation of the discussions relating to the Poverty Reduction and Growth Facility (PRGF) programme with the IMF and WB. The PRGF commenced on April 2003. The IMF has agreed to provide a sum of SDR 413.7 million (100 per cent of Sri Lanka's quota at the IMF) over a four year period under the PRGF and an associated Extended Fund Facility (EFF) programme. The first tranche of the funds under the programme, amounting to SDR 59.1 million, was released to Sri Lanka in April 2003. The ERD also co-ordinated work under the Swedish Exchange Programme II with the Riksbank. The provision of economic information to international organisations continued on a regular basis.

The ERD continued to host the SAARCFINANCE Cell of Sri Lanka. SAARCFINANCE, a grouping of Central Bank Governors and Finance Secretaries, was formally recognised as a body under SAARC in 2002. A representative from the ERD participated in the SAARC Day events organised by the Ministry of Foreign Affairs.

The Central Bank of Sri Lanka has been an active founder member of the SEACEN Research and Training Centre and as a part of the ongoing involvement in SEACEN work, the Bank hosted the 3rd SEACEN Course on "Monetary Policies and Strategies" during 21 September – 3 October 2003. The ERD was primarily responsible for the organisation of the course. The Bank continued to participate in the SEACEN Experts Group (SEG) and provide information for the SEG database, this work too being co-ordinated by the ERD. The ERD also made initial preparations for the 39th SEACEN Governors Conference and 23rd Board of Governors meeting to be hosted by the Central Bank in February 2004.

A vital part of the Department's functions is the dissemination of information on economic matters to the general public. Periodic information, varying from daily to annual, has been provided through the Central Bank's website, its publications and the media. An ongoing programme is in place to improve the coverage, timeliness and accessibility of information. There is an increasing demand for information to be available electronically, and the Central Bank's website, maintained by the ERD, now records around 1,500 hits per day. An important development in the dissemination of information was the publication of the entire Annual Report for 2002 on the Bank's website, simultaneously with its release to the public, and the issue of the Annual Report on a CD. The Department continues to compile and release fundamental

information on the monetary and the external sectors, and key interest rates such as the daily Sri Lanka Inter Bank Offered Rates (SLIBOR), the weekly weighted average prime lending rate (AWPR) and the monthly average weighted deposit rate (AWDR), which are now used by market players as benchmark rates. The Department also compiles and publishes monthly trade indices, as well as private sector industrial production indices. The detailed half yearly industrial production surveys were continued, while a new input price index for the industrial sector was computed. The Department commenced a survey of the budgetary performance of local governments, to estimate the performance of all levels of government. The ERD also initiated action to compile and report fiscal data on the basis of the new Government Finance Statistics Manual (GFSM) 2001.

A data dissemination calendar has been posted on the Bank's website to enable the general public to have a greater awareness of the timing of the release of critical economic information. This serves as a valuable guide to the public in planning the receipt of these key economic data.

The Department was responsible for co-ordinating the publication of the Bank's Annual Report for 2002, in co-operation with other departments. The Department also published Recent Economic Developments - Highlights of 2003 and Prospects for 2004 in November, in collaboration with other departments in the Bank, in particular, the Statistics Department. The Monthly Bulletin, containing a wealth of statistical detail, continued to be published by the Department. Action has been taken to revise the format of this Monthly Bulletin to improve presentation and make it more 'reader friendly'. The Department, in addition to providing ad hoc reports to the Ministry of Finance, prepared and submitted to the Minister of Finance the special report under Section 116 of the Monetary Law Act to facilitate the preparation of the Government Budget for 2004. The ERD was also responsible for evaluating all foreign loans obtained by the government and assessing their monetary implications, for the Monetary Board to provide its views on these loans, as required by the MLA.

Officers from the ERD undertook a number of research studies, both to fulfill the Bank's requirements and on their own initiative. Several studies have been selected for publication in the Bank's 'Staff Studies'.

ERD staff functioned as resource persons at seminars, workshops and training programmes conducted by the government and the private sector and foreign institutions such as the SEACEN Centre. They also served as resources persons and members on a number of Sri Lankan teams working on regional trade co-operation (such as SAFTA, BIMST-EC, IOR-ARC and bilateral trade agreements with Pakistan, Egypt, Thailand etc.) and WTO issues. The ERD prepared a draft report for the WTO Second Trade Policy Review Mechanism. Officers from the ERD also participated in the Study Group on the Indo-Lanka Comprehensive Economic Partnership

Agreement and in the preliminary negotiations related to the Comprehensive Economic Partnership Agreement between Sri Lanka and Singapore and the Economic Partnership Agreement with the USA.

Many senior staff officers of the Department served on important committees, both within the Bank and outside. Among these committees were the Steering Committee on Macro and Trade Policy Framework, Tariff Advisory Council, Financial Sector Reforms Committee, Strategic Intervention in Paddy Marketing, Consultative Committee of the Ministry of Irrigation and Water Management, Fertiliser Tender Committee, Poverty Reduction and Growth Facility Monitoring Committee Taskforce to Develop a Food and Nutrition Policy for Sri Lanka, Ministerial Sub Committee on Sick Industries, Steering Committee on Restructuring State Owned Bus Companies, Taskforce on Profitability and Sustainability of Rice Production in Sri Lanka, Taskforce on Rationalisation of Paddy Purchasing, Processing, Marketing and Stockholding in Sri Lanka, Monetary Policy Committee, Market Operations Committee, Foreign Reserves Management Committee, Training Committee, Domestic Debt Management Committee and Treasury Bills and Bonds Tender Committees. Officers of the Department served on the Boards of Directors of institutions such as the National Development Bank, Board of Investment, Sri Lanka Export Credit Insurance Corporation and Distance Learning Centre Ltd.

In order to improve the technical skills of staff, the ERD undertook continuous training of staff both locally and overseas.

Secretariat

Secretariat Department continued to handle work related to the procurement of Goods and Services for the Bank, Foreign and Local Travel of Bank officials, General Administration, Protocol functions, Leave Policy and Administration and other miscellaneous services. In addition, the Department engaged itself in the promotion of social and cultural activities in the Bank. The social and cultural activities, among other things, helped to improve employer/employee relations, and also relationship among employees.

Some activities such as handling of mail in the Bank and Data Entry Operations of the Secretariat Department were outsourced by the Bank in order to reduce expenditure, and still provide an efficient service. The processing of payments relating to travel, procurement of goods and services etc., for the computerised General Ledger system and the settlement of advances remained with Department even though payments in respect of these were made by the Finance Department.

Security Services

Security Services Department is assigned the task of protecting the Banks' employees, buildings, equipment and property and

also to provide security for the movements of its assets and currency.

The department also provided security at the following exhibitions at which the Central Bank participated. Valuable currency notes and coins including ancient coins were among the Central Bank's exhibits.

- (a) Dirigamana exhibition held at Embilipitiya from 04 – 06 July 2003
- (b) Yuga Dekma exhibition held at Matara from 05 – 11 September 2003
- (c) Yuga Dekma exhibition held at Gampaha from 06 – 10 October 2003
- (d) Holy Cross Trade Fair held at Kalutara from 24 – 26 October 2003
- (e) Yuga Dekma exhibition held in Colombo from 12 – 22 December 2003

In order to equip Fire Wardens and security staff to better perform their duties, the following training was provided to them.

- (a) Fire Classes were held for the Fire Wardens of all departments. This training programme was conducted in liaison with the Colombo Fire Brigade. In addition, there was a fire evacuation drill for all employees of the Central Bank with the participation of security officers. Fire fighting vehicles and equipment were brought for this evacuation drill by the Fire Brigade.
- (b) Annual weapon training and firing was conducted for the security officers on 22, 23 and 29 November 2003.

Statistics and Field Surveys

The Statistics Department continued its compilation, analysis and dissemination of (a) data on national accounts, prices and wages, labour force, employment and other socio economic indicators and (b) micro level data on households and the business sector through its surveys, in 2003 as well. The Department continued to engage in developing new statistical exercises to supplement existing statistics in its specific areas of responsibility with a view to enhancing quality, timeliness and coverage in its dissemination of economic statistics.

In particular, several methodological improvements were made in the compilation and dissemination of national income estimates. Meanwhile, quarterly GDP data continued to be disseminated to the public through media conferences strictly adhering to an Advance Release Calendar published at the beginning of the year.

During 2003, the Department finalised all planned activities to conduct the eighth survey in the series of Consumer Finances and Socio Economic Surveys commencing October 2003 as specified in the Monetary Board decision made in early January 2003. All major tasks, which included the preparation and printing of survey questionnaires, sample selection and

preparation of field plan, field staff recruitment and training, correspondence with government authorities, publicity, the conduct of pilot surveys and development of the data processing plan were completed according to a planned calendar of activities prepared in 2002. The survey commenced in early October and successfully completed the first round of one calendar quarter in late December 2003.

Another key event during the year was the conduct of a special seminar to celebrate the 25th anniversary of the Country Wide Data Collection System (CWDCS) or "Deepadatta" in Sinhala, of the Statistics Department, which commenced in 1978. The seminar and awards presentation for teachers who function as statistical investigators in around 100 centres across the country was held on 27 September at the Centre for Banking Studies (CBS). The Governor of the Central Bank was chief guest and the Director-General of the Department of Census and Statistics was the Guest of Honour on this occasion.

The regular and close monitoring of price movements in retail and wholesale markets across the country is a key responsibility of the Department. The Department continued to prepare regular and timely analytical reports on price developments for policy makers towards facilitating macro economic management. Meanwhile price dissemination initiatives relating to retail and wholesale market prices through the print and electronic media, continued as usual.

Efforts were also made to improve the coverage and content of the Department's two regular publications, namely Sri Lanka Socio Economic Data 2003 and Economic and Social Statistics of Sri Lanka 2003 by introducing new tables to provide more regionally disaggregated economic statistics and rationalising obsolete statistical tables in both publications. The former was made available to the public in both print and electronic media.

During the year under review more training opportunities were made available to the officers of the Department when compared to 2002, which helped them to enhance their professional capabilities. Accordingly, 17 staff officers and 20 non-staff class officers underwent training conducted by CBS, MDC and other local agencies, while specially relevant foreign training was received by five staff officers.

As in 2002, on a request made by the Department of Statistics of the University of Colombo, the Department provided industrial placement facilities for two of its undergraduates for a period of 8 weeks from July 2003. In addition, senior officers of the Department served on and contributed to several committees and fora at the national policy level.

Surveys

Consumer Finances and Socio Economic Survey 2003/04

The Statistics Department finalised all related activities in order to conduct the above survey and commenced data collection

from sampled households in early October 2003. This will be continued until September 2004, thus covering a calendar year. During this period, data collection will proceed in four rounds of three months each. This is the 8th survey in the series. The 7th survey was conducted in 1996/97. Designing, planning and preparations for the survey were conducted according to an advance calendar programme that had been prepared in the previous year.

With the conduct of the Census of Population and Housing (Census) 2001, an upto date population frame was available to select the required sample of households for the survey. The Census 2001 could not be completed in 3 districts of the Northern Province viz, Mannar, Mullaitivu and Killinochchi. Hence, these districts had to be excluded from the survey as there was no population frame available from the Census 2001 from which to select a sample. Thus, unlike in 1986/87 and 1996/97, the two previous surveys in the series, which did not cover North and East provinces, this survey covers 22 districts in the country excluding only those 3 districts. Data are expected to be collected from a sample of 11,768 households drawn from 1,509 sampled census blocks. Data collection in Round 1 of the survey from 2,897 sampled households has been already completed and the processing of data is now in progress.

The primary objective of conducting this survey has been to collect comprehensive data on household income, expenditure, consumption, savings and investments. In addition, other important data including demographic features, housing conditions, socio economic conditions, labour force data and employment statistics will be collected in this survey. Over the last five decades, the Consumer Finances and Socio Economic surveys (CFS) have been a major source of information on changes in socio economic conditions in the country. These data have been widely used by decision makers in both the public and private sectors, planners, researchers, students, social workers, international aid agencies and the general public. Moreover this survey series provides a mechanism for meeting emerging data needs relating to poverty and economic progress on a continuous basis.

Another important aspect of conducting CFS is that the latest data on consumption expenditure will be available and this will strengthen compilation practices of national accounts where plans are underway to revise the compilation procedure and definitions from the current System of National Accounts (SNA) 1968 version to be in line with the SNA 1993 recommendations. Moreover, the revised expenditure schedules of this survey would enable generating and presenting expenditure data based on the SNA 1993 Classification of Individual Consumption by Purpose (COICOP), which is the currently recommended international standard used in the newly compiled Sri Lanka Consumer Price Index (SLCPI) of the DCS. The survey data are also expected to be used effectively to revise, update and improve the base weights of all regional price indices compiled by the Statistics Department.

It is expected that round wise reports based on key survey findings will be released at the completion of each round of the survey. In addition, to statistical findings of the main survey, overall supervision teams in the Department gathered specific information in the field with a view to assessing the economic conditions across different regions in the country over different periods of the calendar year. In this regard, the coverage of the Northern and Eastern provinces was found to be particularly informative since these areas are being covered in the CFS after a lapse of 20 years.

Country Wide Data Collection System (CWDSCS)

The Country Wide Data Collection System of the Statistics Department, which commenced in 1978, completed 25 years of operation in 2003. Regular collection of information on retail prices of consumer goods, producer prices of agricultural commodities, and wage rates pertaining to the informal sector is carried out under this programme. Data collection is accomplished through an island-wide network of school teachers who function as statistical investigators in 93 of around 100 centres established at the inception of the programme. Information thus collected is published regularly through the print and electronic media. The system is also used to identify the impact of changes in the administered prices of consumer items as well as to monitor prices of inputs for agriculture in major producing areas. The sub sectors covered by the scheme include paddy, tea, rubber and coconut cultivation, and also small-scale construction. Seminars were conducted in Matara, Colombo, Anuradhapura and Kandy in 2003, to provide further training for the data collectors in order to improve the quality, efficiency and timeliness of their data collection, as well as to obtain their input on the reasons for differences in price developments across regions identified in the computation of regional consumer price indices. Teacher investigators were also educated about the need to develop a system of collecting information other than prices on the economic activities in the respective regions. They were also made aware of the Central Bank's plans to establish a system of collecting information on the expectations of the general public on price movements and the impact of macroeconomic policies on economic activities.

Computation of Price Indices

Consumer Price Indices

The Colombo District Consumer Price Index (CDCPI), introduced in 1998, continued to be computed by the Department as a supplementary index to the Colombo Consumers' Price Index (CCPI) and the Sri Lanka Consumer Price Index (SLCPI) computed by the DCS. The target population used in this index is the lowest 40 per cent of the district population ranked by income. CDCPI has a broader coverage in terms of the number of items, as well as geographically, than CCPI. The information for the

computation of the index was obtained from 11 centres in the Colombo District. Of these 11 centres, 5 centres, namely, the Pettah Market, Hanwella, Homagama, Moratuwa and Avissawella, were established under CWDSCS and the other centres namely, Kollonnawa, Nugegoda, Dehiwala, Piliyandala, Maharagama and Padukka, were newly introduced in January 1999. Following the outsourcing of the collection of information in these centres to a company, field investigators hired from the company and appointed teacher investigators collected information regularly from these centres throughout the year.

Since 1998, the Department has computed three regional consumer price indices for the districts of Anuradhapura, Matale and Matara. The commodity weights for the indices as in the CDCPI, are based on the expenditure patterns of the respective districts derived from CFS of 1996/97 conducted by the Central Bank. These weights were constructed based on the target population of the lowest 40 per cent of households in the district when ranked by income. These indices are useful in analysing regional price movements. They are also used by market players in negotiating forward sales contracts in agricultural commodities. The behaviour of these district price indices were analysed to provide further insights into price behaviour to the policy makers on a monthly basis throughout the year.

The Statistics Department continued to compile a consumer price index covering the Western Province for internal purposes. This has a wider coverage than CDCPI, both geographically and in terms of household income. The main improvement in this index is the expanded coverage of a consumer price index to higher income households and a wider geographical area. This index represents the lowest 64 per cent of households in the Western Province, when ranked by income taken from the CFS of 1996/97. The weights are based on the expenditure pattern of the representative households. Data collection centres extended beyond major trading centres used for CDCPI, to include super markets in the city to capture changing consumption patterns of the higher income households as well.

In addition to the above consumer price indices, the Statistics Department continued with the analysis of movements of consumer prices based on the movements of SLCPI, newly introduced by DCS with much wider geographical and expenditure group coverage, and the regional indices computed by the Central Bank. SLCPI consumption basket covers 80 per cent of the households ranked by expenditure as reflected in a survey conducted in 1995/1996, for the entire country excluding the Northern and Eastern Provinces and prices from all areas except the Northern Province. The Statistics Department continued to issue a monthly press release on inflation movements as measured by CCPI and CDCPI.

Wholesale Price Index

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

National Accounts

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

In 2003, the Department disseminated quarterly national accounts, through press conferences, according to an Advance Release Calendar. This enhanced public awareness of current trends in economic activity and behaviour. This information continued to be dispersed through the Central Bank web site. Timely dissemination of quarterly national accounts data has also raised public interest in the subject recently.

The quarterly press releases on national accounts cover the developments in the economy by the production method but do not yet analyse the economy by the expenditure method. During 2003, the Department began preliminary work to build a data series on quarterly national accounts by the expenditure method. This exercise helped the department to improve its methodologies and estimation, on a provisional basis. It is expected that this data series could also be disseminated to the public in the near future.

Provincial National Accounts

The Department published statistics on Provincial Gross Domestic Product for the first time in the Annual Report 2002, where a data series was made available from 1996 upto 2001. Provincial GDP is currently compiled on the basis of current factor cost prices. This series provides a comprehensive database on provincial economic activities as well as provincial contribution to national economic development and has been well received by users of economic statistics. Work on compilation of Provincial GDP for 2002 continued throughout 2003.

Employment Statistics

The Department continued the Annual Survey on Public Sector Employment in 2003 as well, with the objective of ascertaining the trends in employment in government ministries, departments, provincial councils, local authorities, corporations and state boards. Further, the survey on Quarterly Public Sector Employment, which was initiated in 2001, was continued in 2003 to ascertain the quarterly trends in public sector employment for the use of policy makers and for the estimation of the value addition in the Public Administration and Defence sector of the GDP Accounts.

STANET and Web Page

The Department through its web page 'STANET' in the Local Area Network of the Central Bank continued to provide access to key data and press releases, as well as the latest information on the Department's functions and activities. The integrated network system provides access to and sharing of data bases between divisions and other departments of the Bank as well as the web page of the Central Bank.

Publications

During the period under review, the Department continued its activities in connection with two annual publications. The Department released 'Sri Lanka Socio-Economic Data 2003 – Volume XXVI' in June while all arrangements were completed to publish the 'Economic and Social Statistics of Sri Lanka 2003 – Volume XXV' publication during the year.

These two publications carry comprehensive time series and cross-sectional data on socio-economic variables, including demography, labour force and employment, national income and expenditure, agriculture, industry, external trade and finance, prices and wages, money, banking, capital market, government finance and socio-economic services. Both these publications were improved further to provide wider coverage of both national and regional economic information. In addition, the Department contributed to several other publications of the Central Bank during the year.

Supervision of Non-Bank Financial Institutions¹

The Department of Supervision of Non-Bank Financial Institutions continued to carry out regulatory and supervisory functions in respect of registered finance companies (FCs) with the objective of ensuring that FCs comply with the minimum prudential requirements stipulated by the Central Bank. These functions were carried out mainly through off-site surveillance and on-site examinations. The Department also registers and monitors finance leasing establishments.

No new FCs were registered during the year. Accordingly, at the end of 2003, the total number of registered finance companies remained unchanged at 26. The total number of registered finance leasing establishments as at the same date was 56.

Off-site Surveillance

The Department continued its off-site surveillance of registered finance companies. In this process periodical returns furnished by FCs were analysed with a view to ascertaining their financial condition and to monitor their compliance with the provisions of the Finance Companies Act and the Directions and Rules issued under it. Returns obtained from FCs included weekly

1. Consolidated Balance Sheets of Registered Finance Companies for the years 1994–2003 are given in Appendix Table 123.

statements of liquid assets, monthly statements of large advances, assets and liabilities and cash flow, quarterly statements of non-performing advances and the annual audited balance sheets and profit and loss accounts. Directions issued under the Act include requirements relating to minimum capital and liquidity, provisioning for bad and doubtful debts, single borrower limits and limits on equity investments.

On-site Examination

The Department conducted comprehensive on-site examinations of two FCs during the year. Examiners of the Department assessed information gathered from books of accounts and other records maintained by FCs in order to examine capital adequacy, asset quality, management efficiency and earning and liquidity. Internal controls and systems and the companies' compliance with statutory requirements were also examined. The findings of the examinations were discussed with the management of the respective companies and corrective action was indicated where necessary. Meanwhile, spot examinations were conducted on other registered finance companies prior to the issue of annual licences for 2004. These spot examinations covered selected critical areas.

Registration of finance leasing business

In terms of the provisions of Finance Leasing Act (FLA), No. 56 of 2000, a certificate of registration is necessary to carry on finance leasing business. During the year 7 institutions comprising 2 commercial banks, 2 finance companies and 3 public companies were registered. At the end of 2003, the number of registered finance leasing establishments stood at 56.

Issue of Directions

Two Directions, namely Finance Companies (Capital Funds) Direction, No. 1 of 2003 and Finance Companies (Risk Weighted Capital Adequacy Ratio) Direction, No. 2 of 2003 effective from 1 July 2003 were issued, while the Finance Companies (Capital Funds) Direction, No. 9 of 1991 was repealed. In terms of the Direction on Risk Weighted Capital Adequacy Ratio, FCs were required to maintain a core capital adequacy ratio of not less than 5 per cent and a total capital adequacy ratio of not less than 10 per cent of risk weighted assets. In terms of the Finance Companies (Capital Funds) Direction, all finance companies are required to maintain capital funds at a level not lower than 10 per cent of their deposit liabilities. The Direction on Risk Weighted Capital Adequacy Ratio will be an added safeguard to look after the assets side of the balance sheet.

Finance Leasing (Reporting Requirements) Direction, No. 1 of 2003 was issued on 21 August 2003 for the purpose of obtaining specified information on a regular basis from finance leasing establishments which are not either licensed banks or registered finance companies.

Failed finance companies

During the year, a liquidator was appointed for Union Trust & Investments Ltd in respect of which the liquidation petition had been pending since September 1999. Accordingly, of the nine failed finance companies the administration and management of which were vested in the Monetary Board under the provisions of the Finance Companies Act, No. 78 of 1988, six were under liquidation at the end of 2003. The Department plans to file petitions for liquidation in respect of two other companies during 2004.

Public awareness programme

In view of the increase in the recent past of the number of institutions mobilising deposits without legal authority to do so, the Department has taken action to educate the public on related matters. The public awareness programme implemented by the Department included the following:-

- (a) Publication of the following in newspapers:-
 - (i) a list of registered finance companies in March 2003 and lists of registered finance companies and licensed banks in July 2003.
 - (ii) two lists giving names of institutions which are not authorised to accept deposits from the public in January and July 2003, in response to inquiries received from the public;
 - (iii) a detailed note clarifying matters relating to acceptance of deposits from the public, in July 2003; and
 - (iv) names of three companies which were conducting finance business in contravention of the provisions of the Finance Companies Act, in September and October, 2003;
- (b) Participation in television and radio programmes to educate the public on matters relating to acceptance of deposits by unauthorised parties.

In addition, heads of media institutions were requested to exercise care in publishing advertisements soliciting funds from the public by institutions which are not authorised to accept deposits.

Investigation into activities of parties mobilising funds from the public

The Department conducted investigations into affairs of several institutions which were allegedly taking money from the public either as deposits or in a manner akin to deposits. Investigations conducted in respect of three institutions were concluded during the year. Regarding those three institutions appropriate action has been taken under the provisions of the FCA. Meanwhile, legal action was instituted against four companies which failed to provide information for investigations to ascertain whether such companies were conducting finance business. The

Department also provided necessary information to the police to enable the institution of legal action against several institutions regarding complaints that had been received. The Department also assisted the police, particularly by giving evidence in cases filed by them against institutions which were reported to have mobilised deposits without legal authority.

The Centre for Banking Studies

In 2003, the Centre for Banking Studies (CBS) continued to help build capacity and nurture skills of officers in the Central Bank and in the financial sector by conducting a wide range of short term training in Banking Operations, Bank Supervision, Management, Financial Sector Development and Economic Management and programmes for the rural sector. CBS also conducted long term courses in Information Technology (IT), Language Competence and Communication Skills. A total of 71 training programmes were conducted in 2003, as against 55 programmes conducted in 2002, to meet the increasing demand

for training from within the Bank and from the financial sector. The number of participants too increased from 1,009 in 2002 to 1,474 in 2003. Of the total number of participants, 51 per cent were Central Bank officers, while the balance 49 per cent were mainly officers from commercial banks and Regional Development Banks. In addition, the Centre continued to conduct its monthly public lecture series intended to disseminate knowledge and as a discussion forum on topics of current interest.

Table II-26 provides information of the broad areas in which training programmes were conducted in 2003. The number of Central Bank officers following IT courses increased from 240 in 2002 to 314 in 2003. CBS introduced courses such as 'Web Designing for Beginners' and 'Advanced Web Designing' in 2003, which were well attended. These courses provided the skills needed for officers to design and update departmental web sites. The language course on English for Professional Purposes was popular among Central Bank officers. For the first time CBS introduced a course in Basic

TABLE II – 25
Commemoration Lectures and Public Seminars Conducted in 2003

Date	Topic	Lecturer
January 14, 2003	Economic Reforms in Emerging Economies	Prof. Jeffrey Sachs Director, Earth Institute, Columbia University
January 30, 2003	How Small Open Economies Survive in a Competitive Environment	Mr. Yves Mersch President, Central Bank of Luxembourg
February 6, 2003	The Constitutional Position of a Central Bank (Independence Commemoration Lecture)	Prof. Charles Goodhart Advisor, Financial Regulation, Bank of England
March 21, 2003	Reforming Laws Relating to Business	Mr. K Kanag-Esvaran, Attorney-at-Law
April 24, 2003	Informal Finance Revisited	Dr. Nimal Sanderatne Visiting Senior Fellow, Post Graduate Institute of Agriculture, University of Peradeniya
May 7, 2003	Growth with Peace and Economic Reforms	Dr. A G Karunasena, Director, Economic Research Dept., Central Bank of Sri Lanka
May 29, 2003	Financing for Development and the North South Dialogue (Republic Commemoration Lecture)	Dr. Barry Herman Chief, Finance & Development Branch/DPAD, Dept. of Economic & Social Affairs, United Nations, New York.
July 7, 2003	Regaining Sri Lanka: Lessons from World Bank Structural Adjustment Lending	Prof. William H Branson, Economics Dept., Princeton University, USA
July 31, 2003	Restructuring and Overcoming the Odds - True Story of a Public Sector Bank	Mrs. Ranjana Kumar, Chairperson, Indian Bank
August 28, 2003	Intellectual Property Rights: Theory, History and Development (53rd Anniversary Lecture of the Central Bank of Sri Lanka)	Prof. Deepak Nayyar, Prof. of Economics, Vice Chancellor, University of New Delhi
October 16, 2003	Legal Issues Relating to Bank Regulation - Experiences of Other Countries	Dr. Tobias M C Asser, Formerly Adjunct Professor in International Finance and Private International Law, Georgetown University, USA
November 6, 2003	Making of Modern Sweden-Welfare Through Market Principles	Dr. Lars Heikensten, Governor Riks Bank, Sweden
November 21, 2003	Challenges to Monetary Policy in a Global Context (22nd Anniversary Lecture of the CBS of Central Bank of Sri Lanka)	Dr. Rakesh Mohan, Deputy Governor Reserve Bank of India
December 19, 2003	Transformation of Non-Government Organizations into Regulated Financial Institutions : Expectations and Achievements	Dr. Nimal A Fernando Lead Rural Finance Specialist Asian Development Bank

Source : CBS, Central Bank of Sri Lanka

TABLE II – 26
Training Programmes Conducted by CBS in 2003

	No. of Programmes	Trainees			Total Training Hours
		CBSL	Other	Total	
Banking Operations	9	42	187	229	150
Bank Supervision	7	18	199	217	108
Financial Sector Development	6	36	132	168	66
Information Technology	23	314	6	320	828
Languages and Communication Skills	7	173	1	174	368
Management	4	44	22	66	48
Rural Sector	5	–	123	123	84
Special Programmes	10	131	46	177	381
Total	71	758	716	1,474	2,033

Source : CBS, Central Bank of Sri Lanka

Tamil to its curriculum, to enable officers to have a general understanding of the language and be able to communicate effectively. Since there was a good demand for this course, a special programme was also conducted in the year. At the request of the Training Department and the Human Resources Department, CBS conducted a Familiarisation Programme and three IT courses on computer literacy for newly recruited staff officers to the Bank.

Courses in Banking Operations, Bank Supervision and Financial Sector Development and Economic Management were more popular with participants from commercial banks and other financial sector institutions. Since there was high demand for the course in 'Law Relating to Lending and Financial Transactions, CBS had to conduct two additional programmes as special programmes to accommodate the large number of applicants for this course. The popularity of programmes on 'Management of Government Debt', 'Financial Statement Analysis', 'Determinants of Interest Rates and Exchange Rates' and 'Hire Purchase and Lease Financing' in 2002, resulted in CBS conducting two programmes in each of these topics in 2003. Further, CBS conducted three programmes on 'Legal Aspects on Documentation for Advances' and 'Lending on Pledge of Jewellery' in 2003, due to the popularity of these courses in 2002. CBS conducted 05 courses, such as courses in 'Appraisal of Rural Projects', 'Evaluation and Administration of Development Credit', especially for personnel in the rural financial sector. Most of the participants at these programmes were officers from Regional Development Banks. These courses could be made more meaningful and beneficial to participants if residential facilities are available at CBS.

For the fifth successive year, CBS continued with the monthly public seminar and commemoration lecture series, that provide a forum for professionals, academics and the public to exchange views and share experiences on new ideas in the field of banking, finance, economics and other relevant subjects. Table II-25 provides information of the 14 seminars/lectures

conducted (two more than the number originally scheduled) which were well attended.

Training

In order to perform the Central Bank's newly defined core objectives of maintaining economic and price stability and financial sector stability, training has been recognised as a vital component for building the staff capabilities. Therefore, the Central Bank continued to train its staff at all levels, both locally and abroad, by providing them with an opportunity for upgrading their knowledge and professional competencies. During 2003, the Training Department initiated action to formulate a new Learning, Training and Development Policy that satisfies the present and future requirements of the Bank and to meet the future challenges.

During the year under review, 122 officers were trained in overseas short term training programmes, while the number trained locally was 1,103. Out of the 1,103 officers trained locally, 461 officers participated in programmes conducted by local institutions such as the British Council, Sri Lanka Institute of Development Administration (SLIDA), National Institute of Business Management (NIBM), The Institute of Chartered Accountants of Sri Lanka (ICASL) and Chartered Institute of Management Accountants (CIMA) and 642 followed training programmes conducted by the Centre for Banking Studies (CBS) of the Central Bank. In addition, a special training programme was conducted for the benefit of the officers recruited to the staff class to familiarise them with the work performed by all departments in the Bank. They were also given a practical training in the areas relevant to the Bank by arranging visits to institutions such as the Colombo Stock Exchange, Lankaclear Private Ltd. A specific training programme on commercial banking was conducted at CBS for these officers to give them an exposure on commercial banking operations. Several programmes were also conducted on Business English and Report Writing to improve the language skills of the employees. The number of officers trained in short-term programmes and postgraduate studies is given in Table II-27 and Table II-28.

Apart from short term training, officers who were eligible to undertake postgraduate training under the Central Bank

TABLE II – 27
Training of Officers:
Postgraduate Studies 2002/ 2003

Year	No. of Officers Sent for Post-graduate Studies	No. of Officers who Returned after Postgraduate Studies	No. of Officers pursuing Postgraduate Studies as at end year	
			Doctoral	Masters/Post-graduate Diploma
2002	5	2	1	15/2
2003	6	10	1	10/3

Source : Central Bank of Sri Lanka

Scholarship Scheme were permitted to commence their studies at reputed universities abroad. Accordingly, 05 officers were sent for postgraduate studies. Out of them, 04 officers were to undertake postgraduate studies in Economics and Commerce, while one officer was to follow a programme on Information Technology. In addition, an officer who obtained a presidential scholarship to follow a postgraduate degree programme on Information Technology was granted leave to undertake postgraduate studies in January 2003.

During 2003, specific training programmes were also arranged, to meet the training needs of certain departments in the Bank. In view of the need to strengthen the capacity of bank supervision, a special training programme was conducted for the benefit of the staff of the Bank Supervision Department and the Department of Supervision of Non-Bank Financial Institutions in July 2003 with the assistance of the Financial Services Authority, UK. With the implementation of the RTGS and the proposed SSSS, the technology has changed the capacity and the context in which these systems operate. Therefore, it was necessary to train officers who are involved in the payment reforms and securities settlement systems to acquaint themselves with the demands and challenges in this newly developed area. In order to meet this requirement, the Central Bank provided an opportunity for the officers who are directly involved in the work relating to this newly developed area to participate in seminars and training programmes

designed to address the issues relating to these areas to upgrade their knowledge.

The Training Department continued its seminar series scheduled for Thursdays by inviting officers who have undergone training to conduct seminars. This was one of the methods to impart their newly acquired knowledge to other officers in the Bank and to share their experience. In addition, 33 foreign and local resource persons with vast experience in their respective fields were invited to conduct seminars to create awareness and to promote open discussions on topics of current interest to the Bank. Prof. William H Branson, Prof. Charles A E Goodhart and Prof. C Krikpatrick were among the guest speakers who conducted these seminars. A special lecture was arranged on research methods for the benefit of postgraduate aspirants to help them in their research. Mr. Howard Schuman, the Human Resource Advisor, also conducted training sessions on executive public relations skills and training strategy. He also conducted several sessions on the new performance evaluation scheme which the Bank is contemplating to implement. On requests made by officers who are following training courses in reputed institutions on subject areas relevant to the Bank, the Bank decided to reimburse the cost of such programmes subject to the conditions stipulated by the Bank.

Welfare

The Welfare Department continued to provide facilities and amenities necessary to improve the quality of life of the employees of the Bank and their dependants through the provision of medical benefits and health facilities at the Bank clinic, staff loan facilities and other facilities during the year 2003.

With the reduction of market interest rates, the Welfare Department initiated action to obtain approval to reduce interest rates on housing loans and other loans to the staff. Further, taking into account the cost of real estate values and the cost of construction, consideration was given by the department to obtain approval to enhance the quantum of housing loans. Further, the Department took steps to explore the possibility of making arrangements to obtain condominium units for the staff through State Housing Institutions such as the Housing Development Finance Corporation and the Urban Development Authority.

In addition to administering the Medical Benefit Scheme (MBS) for employees, pensioners and their dependants, the Department also provided financial assistance for special surgeries such as heart, brain and kidney operations and also for treatment for cancer and rare and incurable diseases under Categories C, D and E of the medical scheme to pensioners and their spouses who joined a contributory scheme for the purpose. Out of 1,467 pensioners of the Bank, 1,173 pensioners (nearly 80 per cent) have enrolled and 940 spouses of pensioners have also been registered to enjoy these facilities. In May, the facilities under Categories C, D and E were extended under a contributory scheme to widows and widowers of employees. Consequently, 106 widows/widowers have joined the

TABLE II – 28
Training of Officers:
Short-term Training Programs / Seminars – 2003

Department	No. of Officers Trained			
	Foreign		Local (CBS)	
	2002	2003	2002	2003
1. Economic Research	24	23	27	57
2. Bank Supervision	24	19	54	48
3. Information Technology	7	7	10	6
4. Secretariat	8	6	22	42
5. Employees' Provident Fund	1	5	61	60
6. Public Debt	14	10	17	22
7. RDD (a)	13	9	28	40
8. Centre for Banking Studies	2		12	19
9. Currency	3	3	31	28
10. HRD	6		14	26
11. Exchange Control	6	4	23	24
12. Management Audit	2	3	13	20
13. Premises			13	26
14. Statistics	2	5	18	31
15. SNBFI	6	3	34	35
16. Welfare	1	1	22	24
17. Training	1	2	10	11
18. Security Services	3		15	22
19. Legal	3	2	1	9
20. Information (including Library)	1		28	31
21. FD	3	2	13	24
22. DOD	2	4	7	12
23. IOD	14	8	11	13
24. PSD	7	5	13	12
25. MDC	1	1	3	
Total	154	122	500	642

(a) Regional Offices included Source : Central Bank of Sri Lanka

contributory scheme. During the year 2003, seventeen beneficiaries, including employees and pensioners had been paid an amount of Rs.5.6 million for undergoing special surgeries under the Contributory Medical Scheme.

During the year under review, the Department launched an internal web-site for the use of the employees to enable them to obtain information about all welfare schemes of the Bank. The Department also continued to use new technology in processing the loan applications under the staff loan schemes.

While providing the canteen facilities to its employees, the Department was able to undertake catering services for several official functions and International seminars hosted by the Central Bank.

Human Resources Development

The Human Resources (HR) Department continued to perform its functions in the areas of recruitment, placement, promotions, performance management and competency assessment in a more strategic manner.

Performance Management System

During the year, special attention was paid to the implementation of a new Performance Management System (PMS) in the Bank to create a performance oriented work culture, which stimulates personal and professional success and the productivity of the organisation. In this regard the services of an Advisor on Human Resources Management was obtained in March 2003. In addition, assistance was obtained from the Swedish Central Bank to study the existing Human Resources policies and to recommend appropriate measures towards improvement of the HR policies and practices in the Bank. In the meantime, at the request of the HR Department, two HR Consultants visited the Central Bank and had a series of discussions with senior staff in order to improve HR functions.

With the introduction of the new PMS, HR Advisor conducted a series of training sessions to create awareness among the staff. The new PMS is being implemented in three phases and it is subject to a continuous review process. The first phase is to complete and review the job descriptions, secondly the setting of performance goals for employees and thirdly the evaluation of the performance of employees through one to one discussions between the staff member and the supervisor. Representatives were also appointed for each Department to co-ordinate the process.

Recruitment

During the year, 38 Staff Officers were recruited to the Bank for the disciplines of Economics, Statistics, Accountancy, Management, Information Technology and Law. A new Director of Security Services was recruited on contract basis in April 2003. Action was also initiated to recruit a few professionals as advisors and consultants in areas such as of Economic Policy, Banking and Finance, Information Technology, Mass Media and Law in order to upgrade some

functions and responsibilities of the Bank. With on going modernisation process the Bank identified that some departments require strengthening to meet the challenges of modern central banking.

Promotion

During the year, under the new policy of Human Resources Management, the Bank decided to broad base the selection process in relation to promotion. Accordingly, the 166 eligible officers were interviewed and 29 employees, based on performance and suitability, were promoted from Non-Staff Class to Staff Class Grade 1 of the Bank. On the same basis, 4 Non-Staff Class employees were promoted and appointed as Assistant Superintendents of Currency in Staff Class Grade 1.

Manpower Planning

In the year 2003, 17 employees retired and 5 employees resigned from the Bank Service. By the end of the year 2003, there were 433 Staff Officers, 623 Non Staff Officers and 134 Minor Employees in Bank service. Based on the mandatory and optional retirement age of the employees, the table below shows that during the next seven year period, a considerable number of officers will retire from the Bank service. Hence manpower planning and job evaluation exercises are being carried out.

Reaching of Compulsory Retirement Age & Optional Retirement Age

Age	2004	2005	2006	2007	2008	2009	2010
55	44	37	59	63	62	66	62
56	28	44	37	59	63	62	66
57	18	28	44	37	59	63	62
58	9	18	28	44	37	59	63
59	11	9	18	28	44	37	59
60	11	11	9	18	28	44	37
Over 55	121	147	195	249	293	331	349

Meetings Attended by the Governor

The Governor Mr. A S Jayawardena attended the following meetings during 2003.

1. 38th SEACEN Governors' Conference and 22nd Meeting of SEACEN Board of Governors in Manila, Philippines from 13 – 14 February 2003.
2. G-24, IMFC and Development Committee Meetings 2003 in Washington, USA from 08 – 13 April 2003.
3. Tokyo Conference on Reconstruction and Development of Sri Lanka in Tokyo, Japan from 09-10 June 2003.
4. 32nd Meeting of the Board of Directors of the Asian Clearing Union in Bangalore, India from 16 – 17 June 2003.
5. Banking and Financial Services Symposium 2003, Central Bank Governors' Symposium 2003 in London, UK from 25 – 27 June 2003.
6. 73rd Annual General Meeting of the Bank for International Settlements in Basel, Switzerland from 28 – 30 June 2003.
7. IMF/World Bank Annual Meeting in Dubai from 15 – 23 September 2003.

8. Opening Ceremony of the Bangladesh Branch of the Commercial Bank of Ceylon Ltd., Dhaka, Bangladesh, 08 – 15 December, 2003.

Appointments

1. The following appointments were effected from 16 March 2003

- (i) Ms. J P T De Zilva, Deputy Director of Bank Supervision as Acting Additional Director of the Bank Supervision Department and subsequently appointed as the Acting Director of Bank Supervision with effect from 07 April 2003.
 - (ii) Mr. S Wijesinghe, Deputy Superintendent of Currency as Acting Additional Superintendent of the Currency Department.
 - (iii) Dr. P W R B A U Herat, Deputy Director of Economic Research as Acting Additional Director of the Economic Research Department.
 - (iv) Dr. H N Thenuwara, Deputy Director of Economic Research who was also functioning as Acting Additional Superintendent of Public Debt, as Acting Additional Director of the Economic Research Department.
 - (v) Mr. S Somapala, Deputy Secretary as Acting Additional Superintendent of the Employees' Provident Fund Department.
 - (vi) Mr. E A Hettiarachchi, Deputy Director of Information Technology as Acting Additional Chief Accountant of the Finance Department.
 - (vii) Mr. S H A M Abeyratne, Deputy Director of Human Resources as Acting Additional Director of the Human Resources Department.
 - (viii) Mr. G L Amarasena, Deputy Director of Premises as Acting Additional Director of the Premises Department and subsequently he was appointed as Acting Director Premises with effect from 01 December 2003.
 - (ix) Mrs. C Premaratne, Deputy Director of Economic Research as Acting Additional Superintendent of the Public Debt Department.
 - (x) Mr. W M Karunaratne, Deputy Director of Regional Development as Acting Additional Director of the Regional Development Department.
 - (xi) Mr. H M P Herath, Deputy Director of Non-Bank Financial Institutions Supervision Department as Acting Additional Director of the Non-Bank Financial Institutions Supervision Department.
2. Mr. Howard Schuman was appointed as the Advisor of Human Resources with effect from 17 March 2003, on contract basis.
3. The following appointments were effected from 07 April 2003.
- (i) Mrs. P P Sirisena, Director of Bank Supervision as Director Training and Acting Director of the Management Development Centre.

(ii) Mrs. C K Nanayakkara, Director of Training and Acting Director Management Development Centre as Director of the Information Department.

(iii) Mr. J M T B Jayasundara, Director of the Information Department as Advisor, Central Bank Strengthening Project.

4. Mr. W P P Fernando was appointed as Director of the Security Services Department of the Bank with effect from 15 April 2003, on contract basis.

5. Mr. George Gregorash was appointed as the Advisor of Bank Supervision with effect from 13 June 2003, on contract basis.

6. Ms. C I Fernando was appointed as the Consultant of the Bank Supervision Department with effect from 01 October 2003, on contract basis.

7. The following promotions and appointments were effected from 01 December 2003.

(i) Mr. H A G Hettiarachchi Controller of Exchange was promoted to Special Grade as Senior Head of Department and as Co-ordinator of the work of the Departments of Human Resources, Training and the Centre for Banking Studies.

(ii) Mr. W S L Fernando Secretary was promoted to Special Grade as Senior Head of Department and as Co-ordinator of the work of the Departments of Premises and Welfare.

8. Mr. L Y Dharmasena, Director Premises Department was appointed as Additional Controller of Exchange Control Department with effect from 01 December 2004.

Resignations and Retirements

1. Brig. G Angammana, Director Security Services Department (on contract) resigned service with effect from 31 March 2003.
2. Mr. H D Tissera, Acting Additional Director, Center for Banking Studies retired from the Bank service with effect from 22 August 2003.
3. Mr. D Boyagoda, Assistant to the Governor, retired from the Bank service with effect from 26 December 2003.

Officers on Release

1. Mr. R A Jayatissa to the International Monetary Fund as Alternate Executive Director.
2. Mrs. M A R C Cooray to the Ministry of Finance as Director General-Fiscal Policy.
3. Dr. U Vidanapathirana to the Ministry of Industries as Secretary.
4. Mrs. C Premaratne to the Ministry of Finance.
5. Ms. K Saravanamuttu to the Ministry of Finance.
6. Mr. M J S Abeysinghe to the Ministry of Finance.
7. Mr. S R Attygalle to the Ministry of Finance.