MAKING DREAMS A REALITY...

STATE MORTGAGE & INVESTMENT BANK

ANNUAL REPORT 2012

CONTENTS

MAKING DREAMS A REALITY...

In its 80 years of service to the nation, …our bank has grown from strength to strength… to play a leading role in providing homes for our people ….MAKING YOUR DREAMS A REALITY…

The SMIB has travelled a long and difficult path ….of achieving profitability, while at the same time giving our customers, the citizens of Sri Lanka, the dream of building their own, affordable home…

While continuing to support our key business of providing homes for our nation, in the coming years we will also expand our scope in readiness to support the government’s national plan to improve infrastructure, by expanding our network to reach out to our expanding customer base, with a range of with tailor made financial products/solutions.

In response to the steady growth and expansion of micro finance, SME and agricultural sectors, our expanding branch network is geared to provide the required capital expenditure, to accelerate sustainable growth of these sectors, in our mission of being a valued partner in the development of the national economy.

VISION

To be the Leader in Housing
and Development Finance in Sri Lanka...

MISSION

Whilst strengthening the position of the premier housing finance institution, we are committed to serving all our customers with the best financial solutions to suit their financial needs and to provide our depositors attractive returns with solid security and flexibility. To our employees, we are committed to creating exciting career opportunities and rewards. To our shareholders, we strive to offer the best returns. To the community, we are a responsible corporate citizen closer to their lives. To the state and regulators, we are a partner in national development.

CORPORATE VALUES

In conducting our business we will respond promptly and act creatively, while being committed to:

Trust / Integrity / Accountability / Professionalism / Credibility / Equity / Efficiency and Social Responsibility

FINANCIAL HIGHLIGHTS

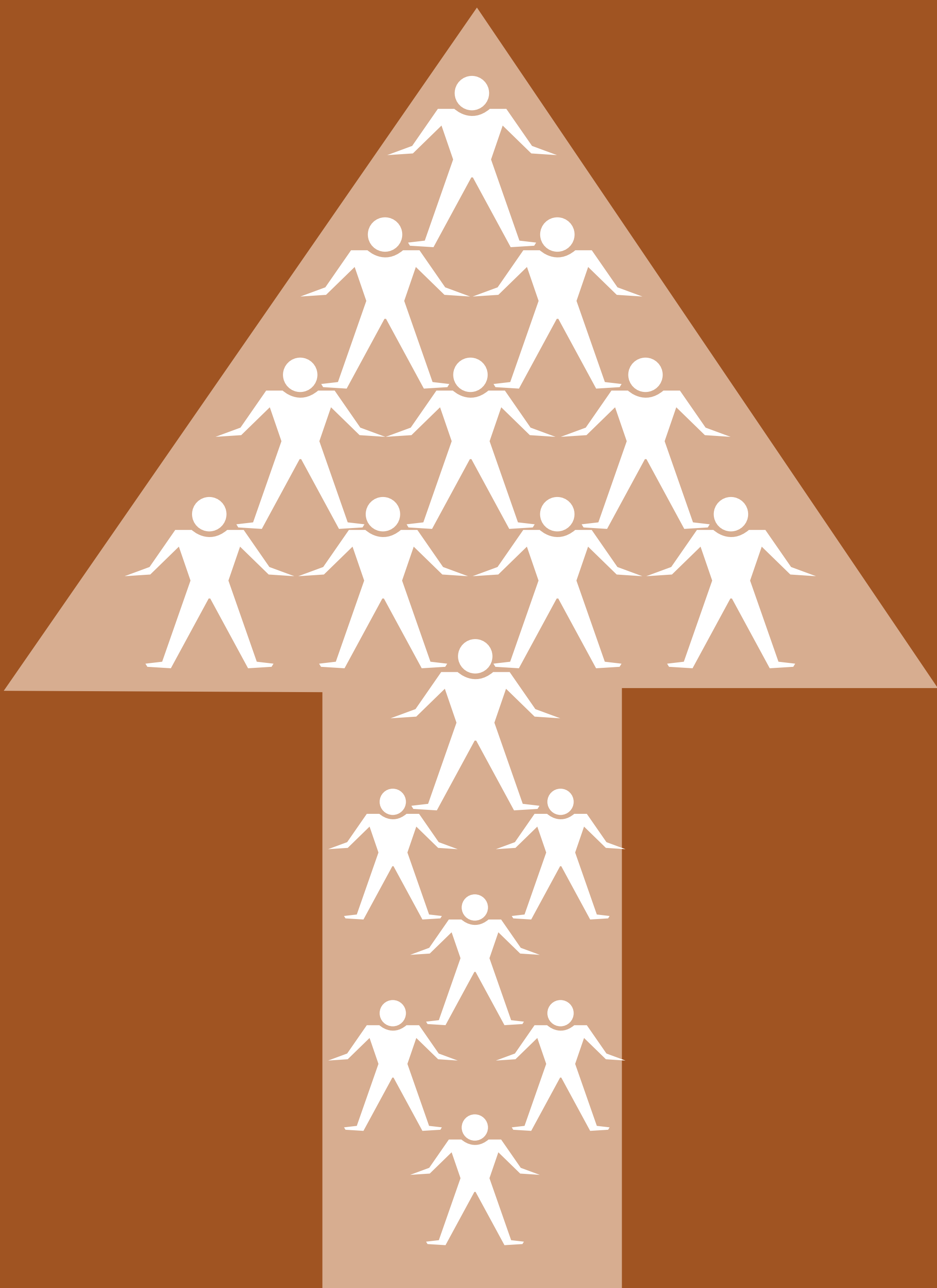
	2012	2011	Change
	Rs. Mn	Rs. Mn	%
Interest Income	2,931	2,611	12.26
Interest Expenses	1,725	1,214	42.12
Net Interest Income	1,206	1,397	(13.68)
Profit before Tax	430	689	(37.51)
Taxation	158	178	(11.50)
Profit after Tax	272	510	(46.60)
Investment in Government Securities	297	92	221.29
Loans and Advance	18,454	16,309	13.15
Total Assets	22,358	20,509	9.02
Customer Deposits	17,237	15,088	14.24
Borrowings	734	668	9.83
Stakeholders' Fund	3,810	3,643	4.57
Ratio Analysis			
Profitability Analysis	**%**	**%**	
Net Interest Margin	5.39	7.26	(25.70)
Return on equity	7.31	14.67	(50.16)
Return on Average Assets	2.01	3.58	(43.89)
Capital Adequacy			
Equity / Total Assets	17.04	17.76	(4.08)
Equity / Gross Loans & Advances	20.66	22.34	(7.58)
Tier 1	33.22	39.94	(16.82)
Tier 11	33.22	39.94	(16.82)
Liquidity			
Liquid Asset Ratio	21.98	20.04	9.68
Deposit/Gross Loans and Advances	93.40	92.51	0.96
Borrowings/Gross Loans and Advances	3.98	4.10	(2.94)
Rating			
Asset Quality	**A(lka)**	**A(lka)**	
NPL/Gross Loans and Advances	37.42	36.79	1.69
Loans and Advance to Total Assets	82.54	79.52	3.79

LOAN DISBURSEMENTS

Rs.4.9 BILLION

MANAGEMENT
INFORMATION

The year past has been one of many challenges for SMIB. However, your Bank has emerged triumphant through its dedication and commitment to achieving performance year on year. Our team has become ever stronger, and through diligent management, we are now closer to accomplishing our vision of becoming Sri Lanka's most preferred housing loan provider.



CHAIRMAN'S MESSAGE

"The year 2012 was a year of change, as we attempted to reposition ourselves as a significant service provider in housing and development finance in the minds of our customers."

CHAIRMAN'S MESSAGE CONTD...

Your bank is one of the oldest banks having an 80 year commendable track record in the housing and property mortgage sector and displayed steady and resilient growth against challenges in the macro economic environment and tight monetory policy which prevailed during the year 2012.

After a robust growth rate of 8% in 2010 and 2011, GDP growth rate of the country was dragged down to 6.4% due uncertainty in the global and local market conditions. World economy has been down graded from 3.8% to 3.3% in 2012 due to sovereignty bond crisis in the European Union and less ebullient in the emerging economies, such condition key to downgraded risk to slow down the growth rate of the country. Evidenced by, declining of export to EU by 9.2% and to USA by 4% pushed widen deficit of current account. It appears that tariff increases on motor vehicle and other luxury items does not derived expected outcome due to slow recovery of the export income and up ward pressure in the imports. Thankful to the Hon. President's leadership for the major infrastructure development projects in progress and effective development policy measures undertaken to milder the negative impact on uncertainties prevailed in the global economies.

Finance market of the country has depicted resilient and modest growth of capital and liquidity despite the uncertain market conditions. Total assets of the sector have been increased by 20% and reached Rs. 05 trillion compared to Rs 4.2 trillion in the last year. Loan and advances has increased by 17% in contrary to up ward pressure in lending rates. Inflationary pressure and immense competition for deposit was evidenced by the 20% growth during the year 2012.

Upward pressure on deposit rates has dragged down the net interest margin keyed to slow growth of the profitability of the bank. Bank has reached an after tax profit of Rs.272 million not withstanding the scope limitation enforced by the Act of Incorporation, total assets based of the bank has been increased by 9% from Rs. 20.5 Bn to 22.3 Bn. Net increase of Loan and advances was 2.15 Bn, marked the 13% growth. To extend the service to other segment we have diversified the portfolio and introduced new products with attractive features to ensure the valued partner in the society, for an instance, to enhance the livelihood and to encourage renewable energy utilization, bank has introduced a new loan scheme to finance the capital expenditure on installation of solar power electricity generation system.

Micro finance, SME sector and agricultural are expected to grow persistently at higher rate in forthcoming year's inline with on going infrastructure development activities and GOSL growth strategies, derived, more responsibilities on finance sector to cope up the needed capital expenditure to accelerate sustainable growth of these sectors, as state bank and also to be a valued partner in national interest, initiatives already taken to expand our branch net work with tailor maid financial solution for growing financial need of SME and other sectors.

We as a state bank committed to extend our service with virtual theme of housing bank to the nation by providing financial assistance to uplift living standard of the society. We ensure continuous service to be a valid partner in national interest. Bank had undertaken many CSR activities including few major projects of initiating to construct new houses for the families liveing in the Cadjan houses in the country.

Appreciation

I extend my sincere appreciation to H.E. the President and Minister of finance Hon.Mahinda Rajapaksa, Deputy Finance Minister, Secretary to the Treasury, Governor of the Central Bank and the Board of Directors of SMIB, General Manager/ Chief Executive Officer and all SMIB staff members who have supported me to discharge my responsibilities as Chairman of the Bank.

Jagath Wellawatta
Chairman

GENERAL MANAGER'S REVIEW

"Deposit growth of 14% recorded for the year 2012, against 10% and 17% deposit growth of the LSB sector and Banking Industry respectively is an incredible achievement of the Bank"

GENERAL MANAGER'S REVIEW CONTD...

2012 was another challenging year for SMIB where rising interest rates on deposits had a remarkable impact on our both top and bottom lines. However, we have continued to sustain our growth and provide financial assistance particularly to our valuable customers to make their dream houses a reality while contributing to the national economy by and large keep in line with other large tax payers. In order to strengthen the customer reach for the purpose of mobilizing deposits, promoting loan products and specifically to improve recovery procedures initiatives were taken to expand the branch network. Similarly we focused more on filling gaps in the human resource and skill development thereof enabling to provide a better, quality service by improving efficiency to witness the competitive advantage.

Interest income of the bank which includes interest on investments and interest on retail lending shows an increase of Rs. 320 mn, resulting to a growth rate of 12.3% compared to the year 2011, against industry average of 38% and the LSB sector performance of 18% in 2012. Banks effort to maintain the liquid assets ratio has resulted to an impact on net interest income in the light of very high interest rates prevailed in the market. As a result of that bank had to pay higher interest to attract and retain deposit customers while facing the competition created in the market. On the other hand we did not increase the lending rates comparatively as a strategy to attract more customers for loans and advances. However, volume of mortgage and EPF loans and advances was not increased as expected. Alternatively bank was able to serve the society by providing personal loans for housing purposes even with a moderate risk when they were deprived under the policy restrictions and other circumstances prevailed during the year under review.

Increase in interest expenses amounting to Rs. 511 million in the year 2012 based on the year 2011 made the turning point for declining the profit curve in the year 2012. Compared to the year 2011 the net interest income has dropped by Rs. 191 million equivalent to 14% drop and making the net interest margin as 5.4% compared to that of 7.3% in 2011.

Bank was able to record of Rs.17,236 million worth of deposits at the end of 2012 while facing the severe market pressure that had an impact on the net interest margin of the bank. Deposit growth of 14% recorded for the year 2012, against 10% and 17% deposit growth of the LSB sector and Banking Industry respectively is an incredible achievement of the Bank.

To increase the deposits bank had to pay a higher rate of interest to attract and retain deposit customers when other banks offer negotiated interest rates. Other reason which gave rise to expenditure is the staff cost that was increased with effect from 1st January 2012 as per the revised collective agreement.

Cost to income ratio of the bank for the year 2012 has been increased to 63% from 45% in 2011. However, bank contributed Rs.429 million to the national income by way of taxes in 2012.The bank's assets grew by 9% reaching Rs. 22,359 million in 2012 against the banking industry and the LSB sector growth of 20% and 10% respectively.

During the year 2012 retail lending increased to Rs. 18,453 mn representing 13% growth. The bank has granted loans amounting to Rs.458 mn for agricultural, Rs. 49 mn for tourism and Rs. 17,946 mn for housing purposes. Loans given for housing purposes represent three major categories namely mortgage, EPF and personal based on the securities offered.NPL ratio of the bank remained at high side irrespective of the sound credit evaluation process.

Bank's Tier 1 and Tier 11 capital stood well above with the regulatory minimum of 5% and 10% respectively. Liquid assets ratio too stood at 20% meeting the minimum statutory requirement. The bank adopted the Sri Lanka Financial Reporting Standards and Accounting Standards (SLFRS and LKAS) with effect from 1st January 2012 in par with other banks. The actuarial valuation was carried out for retirement benefits and necessary adjustments / disclosures were made in the Financial Statements as at 31st December 2012.

Ms. W.J.K.Geeganage
Acting General Manager

BOARD OF DIRECTORS

1. **Mr. Jagath Wellawatta**
   Chairman
   Mr.Jagath Wellawatta was appointed as the Chairman of SMIB in May 2010. He was reappointed as the Chairman of SMIB in 2013. He brings to SMIB a wealth of experience from his tenure as the Chairman of National Child Protection Authority and Foreign Employment Bureau of Sri Lanka.Mr.Wellawatta holds Masters and Honours Degree in Sociology from University of Colombo. He is currently reading for his Phd in Sociology. He is also a Senior Lecturer at the University of Colombo.

2. **Mr. D.Weerasekara**
   Director
   Mr.Weerasekara has been with SMIB since 2006 as a Director. He was reappointed to the BOD in 2009,10 and 2013 consecutively. He holds over 10 years experience in Sri Lanka Education Administrative Service.Mr.Weerasekara currently serves as a Divisional Educational Director.

3. **Mr. V.S.Bandara**
   Director
   Mr.Bandara is an Attorney - at – Law, Notary Public and Commissioner for Oaths.He was appointed as a Director of SMIB in 2010. He was reappointed to the board in 2013. He also holds BA(Honors) in Criminology and Criminal Justice. Mr.Bandara brings managerial skills and experience from his tenure as a Director in People's Leasing Company.

4. **Mr. M.Y.M.Shamraz Yehiya**
   Director
   Mr.Yehiya was appointed to the Board of SMIB on 17th of May 2010. He was reappointed to the board in 2013. He has been engaged in private sector over twelve years.He is currently a Director at Ceylinco Stock Brokers and Continental Business Exchange.

3 8 2 6

5. **Mr. V.M.Ameen**
Director
Mr.Ameen is a Associate Member of Institute of Chartered Accountants, Sri Lanka and a Felllow Member of Chartered Institute of Management Accountants(UK). He also holds a Bachelor of Commerce Degree. Mr.Ameen has more than two decades of experience in Government Service.In addition to his role as a Director of SMIB he is serving as an Additional Director General at Department of Project Management and Monitoring.

6. **Mr. Sarath Hycinth**
Director
Mr.Hycinth was appointed to the Board of SMIB on 14th October 2011.He holds a Higher National Diploma in Management .He has been a Member of Accounting Technicians of Sri Lanka and Fellow of Institute of Public Finance and Development Accountancy of Sri Lanka.Mr.Hycinth is currently the Chief Accountant at Ministry of Livestock and Rural Community Development.

7. **Mr. S.L.G.Bandusiri**
Director
Mr.Bandusiri holds a Bsc and presently employed as Chief Accountant at Ministry of Agriculture.He was appointed to the Board of SMIB on 21st of June 2012.

8. Mr. **P.H.L.W.Perera**
Director
Mr.Perera holds a Masters in Sociology and Bachelor of Arts Degree. Whilst serving as a Director to SMIB he is also serving as the Secretary to Ministry of Construction, Engineering Services, Housing and Common Amenities.

SENIOR MANAGEMENT

Mrs. D.K.Hedellearachchi
AGM(Credit)

Mr. A.D.N. Dharmarathne
AGM(Valuation)

Mrs. S.V.P.Cooray
Chief Manager (Legal)

Mr. E.M.R.L.Munaweera
AGM(Finance)

Mr. K.L.N.A.Perera
Acting Chief Internal Auditor

Mr. K.M.J.S. Karunathilaka
AGM(HR & Logistics)

Mr. T.M.J.Wickramasekera
AGM(Credit)

Ms. W.J.K.Geeganaga
Acting General Manager

Mrs. K.P.K.H.D.Perera
Chief Manager (Recoveries)

Mr. I.N.Fernando
Chief Manager(Valuation)

Mr. S.S. Wijedoru
Chief Manager(HR & Logistics)

Mrs. J. I. Senanayaka
AGM (Risk Management)

Mr. R.P.U. Pathirana
AGM(Recoveries)

Mrs. P.A.C.K. Amarasinghe
AGM (Legal)

Mr. S.Wijethunga
AGM (IT)

Mrs. S.R.De. Silva
Chief Manager (Legal)

Not In Picture

1. **Mr. W. M. Dayasinghe**
   General Manager

2. **Mr. I. K. Gamini**
   Chief Manager(Credit)

FINANCIAL REVIEW

SMIB continued its growth momentum during the year 2012 despite the increased interest rates in the market . Through sound asset management policies and efficient market oriented strategies the Bank successfully faced the challenges in the financial market.

The convergence of SLAS to SLFRS impacted the banking industry with certain changes to financial reporting formats. This being the first financial review under SLFRS regime, explanations and analyses has been provided in comparison to the adjusted financial statements of 2011 under SLFRS for consistency.

Profitability

SMIB recorded a post tax profit of Rs.272 mn for the year ended 2012 which is lower than the previous year. However this decline was mainly due to the high interest expenditure caused by the increased interest rates in the market.

Interest Income

Interest income increased by 12.3% during 2012 backed by the growth in interest rates in the market and the expansion of the loan portfolio of the Bank. By exploiting the favourable rate movements in the investment market, the investment portfolio yielded more than 60% growth in interest income compared to the previous year.

Interest Income Composition

	2012 Rs.Mn	2011 Rs.Mn
Income from Loans and Advances	2,458.41	2314.90
Interest Income from Investments	472.90	296.31
Total Interest Income	2,931.31	2611.21

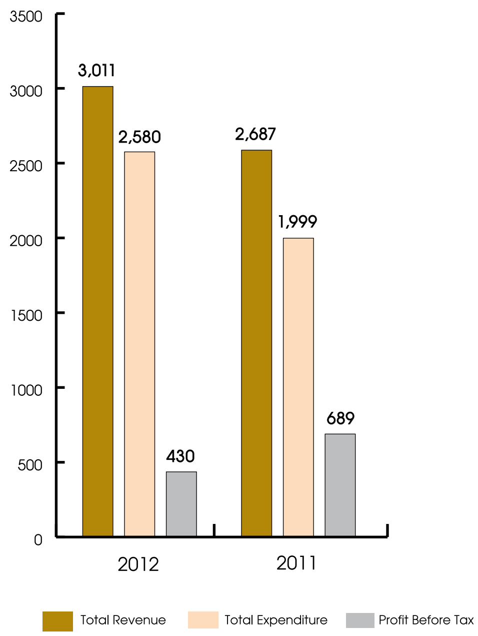
Interest Expenditure

Due to the high interest rates in the market the Bank's interest expenditure increased significantly in 2012.An increase of 42% in the interest expenses compared to 2011 was mainly caused by the competitive deposit rates offered to customers.

Interest Expenses Composition

	2012 Rs.Mn	2011 Rs.Mn
Deposits	1,710.63	1,201.63
Short Term Borrowings	3.17	0.85
Long Term Borrowings	11.40	11.45
Total	1,725.20	1,213.93

Revenue, Expenses and Profit comparison



Operating Expenses

Personnel cost of SMIB increased by 33% due to the salary increments while the other operating expenses showed a minimal increase of only 3.6%.

Impairment Charges for Loans and Other Losses

Impairment charge replaced the provision for loan losses that existed under previous accounting standards. The impairment reversal of Rs.116,716 was accounted in 2012 in comparison to the charge of Rs.16,492,209 in 2011.

The impairment included specific and collective impairment charges and economic factor adjustments.

FINANCIAL REVIEW CONTD...

Portfolio Growth
Loans and Advances

The Bank recorded an increase of 13% in its loan portfolio compared to 2011.This growth can be mainly attributable to the introduction of personal and vehicle loan schemes during the year which attracted a wider customer base.SMIB endeavoured to improve the quality of its credit portfolio while increasing the volume.

	2012 Rs.Mn	2011 Rs.Mn
Mortage Loans	6,520.66	5,738.30
EPF Loans	9,345.49	8,589.78
Vehicle Loans	48.72	-
Personal Loans	637.91	-
Other Loans	1,900.98	1,980.85
Total	**18,453.76**	**16,308.93**

Deposits

The Bank's customer deposits also grew significantly by 14% from Rs.15, 088.05 mn in 2012 to Rs.17,236.56 mn in as at 31st December 2012.Institutional deposit increased by 47% and the retail deposits increased by 3% during the year.

Asset Quality

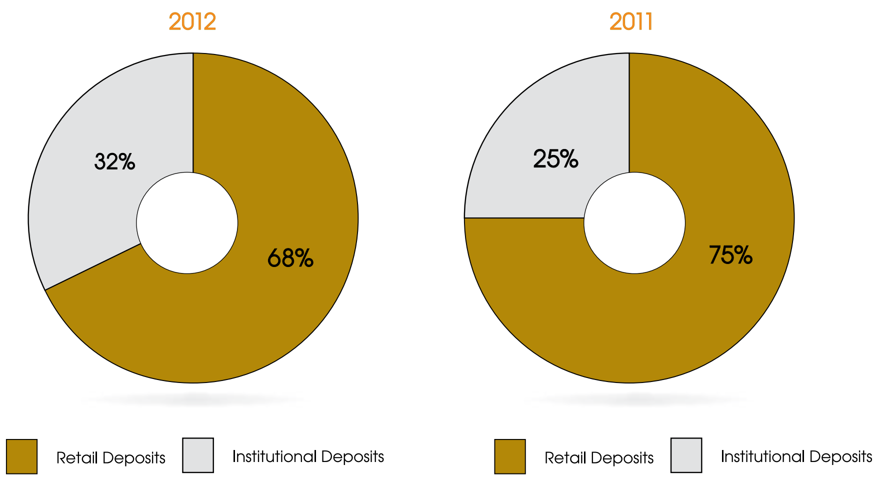
SMIB continued its prudent credit management policy in 2012 increasing its credit volume and maintaining the credit quality simultaneously. Gross NPL ratio of the Bank stood at 37.42% in comparison to 36.79% in 2011. However the NPL ratio has been decreasing during the recent past.

Contribution to National Economy

SMIB as a responsible corporate citizen continued to make a considerable contribution to the economy in 2012 .In 2012 the contribution to national economy in the form of taxes to government amounted to Rs.331.35 mn in comparison to Rs.501.41 mn in 2011.

	2012 Rs.Mn	2011 Rs.Mn
VAT	92.17	146.55
Corporate Tax and Deemed Dividend Tax	237.05	354.80
Investment Fund	25	-
	354.23	**501.35**

Deposits Composition



PRODUCTS AND SERVICES

Our Products & Services

1st January 1979 was a red-letter day for Sri Lanka's banking Sector. On that day, two giants in the housing finance sector merged to be the 'Housing Bank to the Nation'.

The State Mortgage & Investment Bank is the result of the merger of the Ceylon State Mortgage Bank and Agricultural and Industrial Corporation. This union of two powerful financial organizations resulted in a unique institution that caters to the Housing, Agricultural, Industrial and Tourism sectors of Sri Lanka.

The development process of any nation not only encompasses the provision of efficient and effective services, but also must result in the production of physical goods. Both of these complement each other.

The State Mortgage & Investment Bank is one institution that supports these initiatives, catering to all stakeholders, leading to the prosperity of the people. As a state bank, we have always been at hand to support government efforts to achieve its development goals!

As an institution that has served many generations of Sri Lankans, with 8 decades of experience, the SMIB is well aware of the peoples' needs. Indeed it is this rich experience that makes it easy to anticipate the peoples needs in the generations ahead.

As a responsible and respected banking institution, the SMIB is, even now, planning the next generation of financial products and services.

HUMAN RESOURCES

We initiated number of HR development interventions while providing opportunities for our staff to improve their capacities that will be impacting to the Bank performance during next couple of years.

Employee Strength

Staffing Status

The total number of staff at end of the year accounted as 322 which number was comparatively small but they have contributed to the bank performance at greater extent. Twenty (20) staff members left the bank of which 17 members retired from the service of the bank and 3 others resigned (01)/ terminated (01)/ deceased (01) the bank due to various reasons. The rate of attrition accounted as 6.4% which is higher than the last year. There was no significant proportion of attrition during the years.

New Recruitment

Forty (40) staff members including 14 Management Trainees were newly recruited during the year for filling cadre vacancies. They were given comprehensive induction training and made them aware on important aspects of the banking business in order to build their confident on the Job.

Management Trainee receiving her Letter of appointment at the Induction program held in SLFI

Staffing Status

Management Level	End of Year 2011	End of Year 2012
Corporate & Senior Management	18	19
Executive Management	31	28
Executive	114	117
Non Executives	139	158
Total	**302**	**322**

Staffing Variance

Management Level	Variance		
	Retired	Resigned	Recruited
Corporate & Senior Management	1	1	3
Executive Management	4	3	1
Executive	6	0	14
Non Executives	4	1	22
Total	**15**	**5**	**40**

Staff Strength by Tier Wise

Management Level	No of Employees	Percentage
Corporate & Senior Management	19	6
Executive Management	28	9
Executive	117	36
Non Executives	158	49
Total	**322**	**100**

Employee Profiles

Gender Profile

As an equal employee provider, Bank provided employments for both males and females in equal manner. Gender profile of the Bank was accounted as male 52% and female 48%. Male proportion of this year has been increased compared with last year (last year this had been accounted as 49%:51%)

HUMAN RESOURCES CONTD...

Age Profile

It was a privilege to the bank having most experienced and senior staff in key positions. Age profile of the staff above the age of 40 years carried a significant proportion with matured staff that accounted as 62%.

Employee Age Profile

Age category	No: of Employees	Percentage
50 or Above	117	36
40 - 49	85	26
30 - 39	73	23
29 or below	47	15
Total	**322**	**100**

Employee Retention Strategy

It was recognized the staff those who have completed 25 years dedicated service to the Bank. There were 29 eligible employees awarded with gold coins.

Employee Service Profile

Service category (Years)	No of Employees	Percentage
0-4	59	18
5-9	52	16
10-14	52	16
15-19	38	12
20-24	33	10
25-29	47	15
30-34	37	11
35-40	4	1
Total	**322**	**100**

Sixty Six percent (66%) of staff members completed more than 10 years service at the Bank which reflects the level of their satisfaction. Bank could maintain salaries and non salary benefits in par with other government banks through Collective Agreement. During the year Bank signed. Collective Agreement for next 3 years with CBEU granting salary increase by 13-21% from their gross salaries. All permanent staff members are benefited by housing and other loans given at concessionary interest rates.

SMIB introduced a Succession Planning policy and implemented its actions that would help Bank to retain staff those who show potentials to key position for filling future vacancies within the Bank. There has been created a policy link to provide continues ongoing training to improve their professional skills which required for feeder job positions.

Training and Development

Bank developed a Board approved Training Policy and duly approved Training Plan to provide adequate training opportunities for staff which implemented by covering all related subject areas in adoption of systematic approach to staff training development through training need analysis conducted by the Bank. It was also accommodated ad hoc training needs as to give equal opportunities for each staff member to develop their job related skills and attitudes. Some of these training programs were organized in house whereas some other programs conducted with collaboration of professional training institutions by nominating suitable candidates to their programs.

Fourteen Management Trainees were given six months comprehensive training with the resource support of internal and external resource persons which

HUMAN RESOURCES CONTD...

sessions covered in the field of banking, finance and management.

Amongst training opportunities provided by the bank we gave foreign training for five staff members.

By the end of the year staff members attended to 50 training programs covering 1652 man days and incurred expenditure of Rs.5.55Mn. It was revealed that employees spent average five man days for training out of total working days during the year. Most training programs were related to the subject areas of credit and risk management, finance and assets/liability management, human resource management and productivity, attitude development and motivation, IT, marketing and business development, and law.

Organizational Change

Certain amendments were made to the Organizational Structure to address some of issues in order to deliver better customer services. It was able to establish two credit divisions called “Unit A” and “Unit B” by integrating all related functions such as credit appraisal/disbursement, loan administration, loan recovery, legal and valuation processes.

It also made certain amendments to the organizational structure for IT functions of the bank in order to address some of issues which required streamlining the IT functions of the bank to provide better customers services through technological applications and adhering to regulatory requirements.

RISK MANAGEMENT

Risk Management-Management Discussion and Analysis

The fast changing financial environment exposes banks to various types of risk. Financial risk in a banking organization is the possibility that the outcome of an action or event could bring up adverse impacts. Such outcomes could either result in a direct loss of earnings / capital or may result in imposition of constraints on bank's ability to meet its business objectives.

SMIB firmly believes that the robust risk management framework is critical to support a sustainable growth strategy. The bank's risk profiling and management, focuses on the key risk categories of credit risk, market risk, liquidity risk, operational risk, legal risk and strategic risk.

The bank's evolving risk management function involves identification, measurement, monitoring and controlling risks in the above stated areas to ensure that the bank's risk exposure is within the limits established by Board of Directors (BOD) and the risk taking decisions are in line with bank's business strategy and objectives. The bank is creating the culture that the employees who take or manage risks clearly understand it and the risk taking decisions are explicit and clear. The bank has maintained a sufficient capital as a buffer to take risk and the expected payoffs compensate for the risks taken.

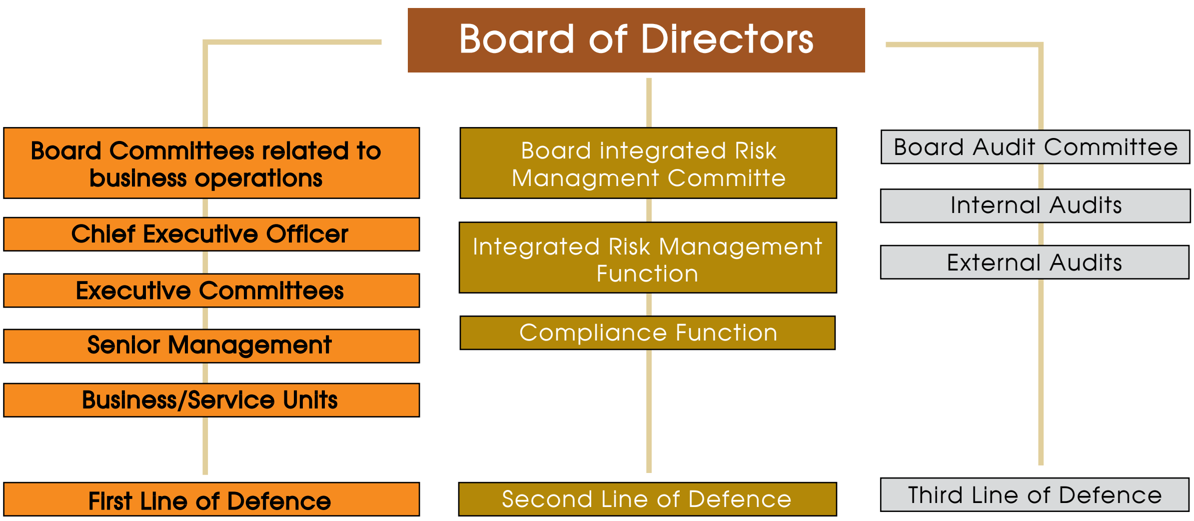
Risk Management Framework of the bank

Risk management structure of SMIB includes three segments comprising of business operation, integrated risk management and audit/compliance. These three lines of defense operate under the guidelines issued by BOD defending bank against unacceptable risk exposures. Key functionality of the mechanism is board and the senior management oversight, policies and procedures defined on the risk management, risk measurement and monitoring controls and the independent audit carried out by the third line of defense.

SMIB has defined risk management policies and procedures with respect to the credit, market and operational risks faced by the bank. The policies and the systems are reviewed periodically to ensure the compliance. Bank's organizational structure clearly defines roles and responsibilities of individuals involved in risk taking and managing activities. Efforts are being taken to internalize the risk management concepts within the bank through capacity building and review mechanisms.

Governances Structure for the Risk Management of SMIB

Since interaction of various risks could result in diminution or increase in risk, the risk management process of the bank recognizes and reflects risk interactions in all business activities as appropriate. Integrated risk management function of the bank has the following structure in place to look at risk interrelationships across the organization.



RISK MANAGEMENT CONTD...

Board and the Senior Management Oversight

Overall responsibility of risk management of the bank rests with the BOD. The board has set qualitative and quantitative measures in order to express the risk appetite and the tolerance limits. It is the duty of senior management to transform strategic direction set by board in the shape of policies and procedures and to institute an effective hierarchy to execute and implement those policies.

Senior management of the bank has to ensure that these policies are properly communicated down the line and embedded in the culture of organization. Risk tolerances relating to quantifiable risks are generally communicated as limits or sub-limits to those who accept risks on behalf of the bank. Qualitative risk measures are communicated as guidelines and inferred from management business decisions.

The bank's risk appetite is monitored and controlled by the risk management function and reported regularly to board, corporate management and relevant committees. Business line managers have to ensure that risk taking remains within limits set by senior management/ BOD. Any material exception to the risk management policies and tolerances should be reported to the senior management/board that in turn must trigger appropriate corrective measures. These exceptions also serve as an input to judge the appropriateness of systems and procedures relating to risk management.

To keep these policies in line with significant changes in internal and external environment, BOD periodically review these policies and make appropriate changes as and when deemed necessary.

The Board has appointed Integrated Risk Management Committee to assist the Board in fulfilling the oversight of the risk management framework of the bank, including significant policies and practices used in managing credit, market, operational capital and certain other risks.

The Board Audit Committee ensures that operational controls are in place and that operations are carried out as per the relevant policies, procedures and guidelines. In particular, it carries out credit audits in line with the prevailing operational controls.

Apart from the board committees, management committees are responsible for focused oversight on designing, implementing and maintaining an effective risk framework and culture in various risk areas. Line business managers are responsible for managing risks in the areas for which they are responsible.

Evolving Risk Management Function of SMIB

Integrated Risk Management Department (IRMD) of the bank was established in 2012 and following key initiatives have been taken during the financial year to establish the risk management function of the bank.

Board Integrated Risk Management Committee (BIRMC), Executive Integrated Risk Management Committee (EIRMC) and sub committees to the EIRMC like Credit and Operational risk management committees were formed and terms of references applicable to each committee was finalized.

Risk Management Policy, Credit Policy, Assets and Liability Management Policy, Liquidity Management Policy and Operational Risk Management Policy were introduced with relevant limits for the management of credit, liquidity and concentration risk.

Credit manual of the bank was reassessed and comprehensive manual was internalized among operational staff to direct the loan processing function.

Credit risk of exposures above a specific threshold is independently reviewed by IRMD prior to approval.
A risk rating model was developed internally to categorize the facility based on the risk profile of the customer and the model is being reviewed on selected sample of existing portfolio.

Loan review mechanism has been initiated to re-assess problem credit and identify early warning signals.

Operational risk management process has been initiated by appointing officers from each businesses unit to liaise with IRMD on reporting operational risk events.

Stress testing has been developed to assess capital and liquidity position of the bank under different scenarios.

RISK MANAGEMENT CONTD...

Capital Adequacy Position

SMIB compute capital adequacy as per the regulator's direction where risk (pillar I) is quantified using the Standard Approach for Credit and market risk and Basic Indicator Approach for operational risk. SMIB's Tier I capital ratio is 28.92% and total capital ratio is 28.92% as at 31.12.2012.These ratios are well above the industry average and indicates a stronger capacity for risk absorption.

The bank is moving towards computation of capital ratios as directed by the standard approach for operational risk from first quarter of 2013.

Managing Key Risks

Credit Risk

Credit risk is most simply defined as the potential that a bank borrower or counterparty will fail to meet its obligations in accordance with agreed terms. Loans and advances granted to counterparties under various product creates main source of the credit risk of SMIB. Risk management function of the bank is focused on setting acceptable credit standards for borrowers and counterparties, sound portfolio risk management and continuous attention to changes in economic or other circumstances that can lead to deterioration in the credit standing of a bank's counterparties.

The bank has developed a credit policy and a credit manual which defines the principles encompassing client selection, due diligence, risk tolerance, review and recovery procedures, portfolio monitoring and management according to the board approved risk appetite levels. These documents guide to identify measure, monitor and control credit risk through establishing an appropriate credit risk environment, operating under a sound credit-granting process, maintaining an appropriate credit administration, measurement and monitoring process, and ensuring adequate controls over credit risk.

The credit policy and the manual is reviewed annually and approved by the Board of Directors ensuring consistency with the bank's risk appetite and the business strategy.

Accountability of the credit risk performance is vested with individual business units and unhealthy trends are addressed at all levels of the bank.

Credit Risk Management

SMIB focuses on following module when managing credit risk.

Initial screening of the borrower and the credit appraisal is done by the risk owners according to the consistent standards guided by the credit manual. Credit appraisal will ensure the borrower's capacity to meet its obligations on a timely manner. Credit officers are educated to maintain the consistency on the credit appraisal process complying with the risk appetite set by the Board of Directors. Credit risk is mitigated by obtaining collateral and guarantees as security and the accepted criteria are set by the policy. Periodic valuation and assessment of realizable value of collateral is carried out as per the regulatory requirement and when required, especially as a part of the recovery action.

Internal risk rating model has been developed by the Risk Management Department of the bank and is in the testing process. The rating model will be applied to rate the clients based on various evaluation criteria. The rating model will be used to assist the risk assessment, credit decision process as well as a tool to be used for risk based pricing.

Independent evaluations of the risk profile of the customers are being carried out by the risk officers and evaluate the risk rating given to the client by the risk owners.

Clear guidelines have been established in the bank for the loan approval structure and the authority has been delegated to different levels in the approval process. No single person can originate and approve the granting of credit. Credit facilities beyond a set threshold will be independently evaluated by the risk officers attached to the risk management division and the comments will be followed when approving such facilities.

The bank is in the process of establishing a credit administration division to ensure efficient post sanction processes and to verify loan releases comply with the bank's set guidelines.

Loan review mechanism carried out by the risk management department of the bank ensures early identification of problem loans to safeguard the bank

RISK MANAGEMENT CONTD...

against possible losses. Credit risk indicators set at the bank level is monitored at frequent intervals to identify early warning signals and to take precautionary actions. Recovery responsibility of problem loans and non performing advances are managed by the credit departments and the recovery department .Credit officers will follow-up the recovery of advances in the initial stages and will be transferred to the recovery department when the loan becomes non-performing. This unit carries out the recovery process until recovery matters are finalized while monitoring the value of the collateral. Recovery department liaise with credit risk management to ensure effective follow-up and learning transfer. Unrecovered advances will be transferred to the legal division to initiate legal action as the last option.

Credit concentration risk

This is the risk of incurring loss due to the excessive exposure on counterparty or a counterparty segment. The bank is measuring concentration risk as per the board approved limits under industry exposure, product exposure and geographical exposure.

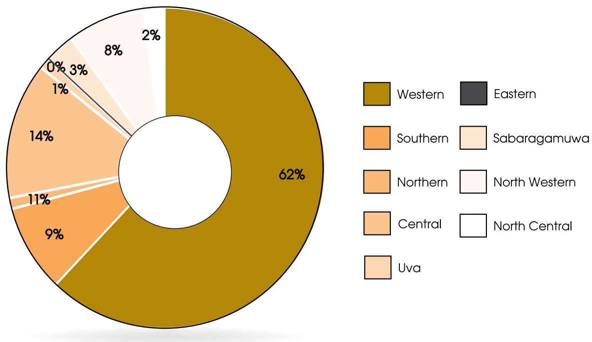
Sector wise Exposure

Industry	Amount (Rs.)
Construction of Houses	7,772,323,302
Home Improvements	5,263,923,586
Purchase of Building Sites	125,755,775
Purchase of Houses	3,016,895,582
Agriculture	395,968,955
Personal Loans	672,455,624
Purchase of agricultural vehicles	61,730,180
Other	1,144,707,278
Total	**18,453,760,281**

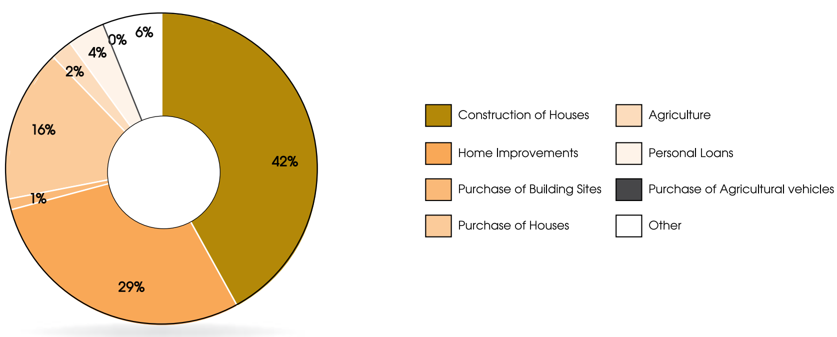
Geographical Concentration

Province	Amount (Rs.)
Western	11,446,238,113
Southern	1,598,667,844
Northern	119,581,619
Central	2,633,303,601
Uva	262,062,679
Eastern	60,296,568
Sabaragamuwa	457,585,605
North Western	1,559,223,927
North Central	316,800,324
Total	**18,453,760,280**

Geographical Concentration



Sector wise Exposure

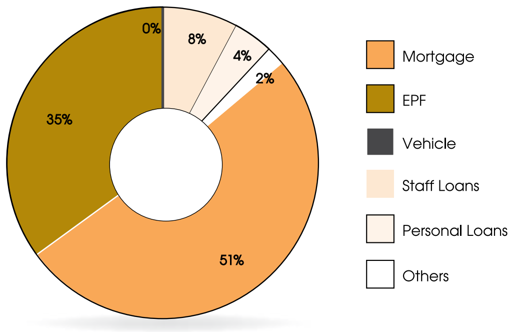


RISK MANAGEMENT CONTD...

Product concentration

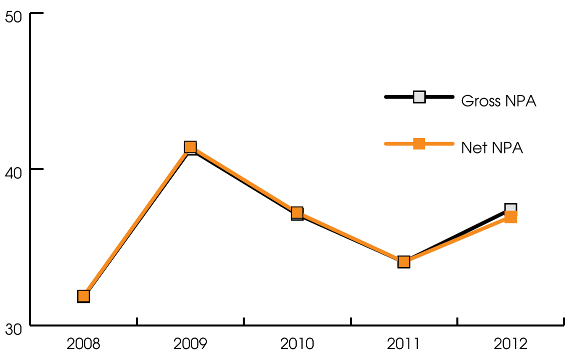
Product	Amount (Rs.)
Mortgage Loans	6,520,663,314
EPF Loans	9,345,488,107
Vehicle Loans	48,719,545
Staff loans	419,864,101
Personal Loans	637,909,931
Others	1,481,115,283
Total	**18,453,760,281**

Product Concentration



Non Performing Advances from 2008-2012

Year	Gross NPA	Net NPA
2008	31.84	31.88
2009	41.28	41.42
2010	37.11	37.22
2011	34.06	34.07
2012	37.42	36.94



Market Risk

It is the risk that the value of on and off-balance sheet positions will be adversely affected by movements in market rates or prices.

For the bank, market risk largely means interest rate and liquidity risk. Bank pays significant additional attention to potential impacts from the volatility of financial markets in general and the housing finance market in particular. Asset and Liability Management Committee (ALCO) is responsible for supervision and management of the market risk and the liquidity risk management function of the bank.

ALCO of SMIB is responsible to monitor the structure / composition of bank's assets and liabilities and decide about product pricing for deposits and advances. The committee decides on required maturity profile and mix of incremental assets and liabilities.

Articulate interest rate view of the bank and decide on the future business strategy, review and articulate funding policy are some of the functions done by the committee at present. SMIB has board approved assets and liability management policy and contingency funding plan in place to deal with liquidity issues.

Interest Rate Risk

Interest rate risk arises when there is a mismatch between positions, which are subject to interest rate adjustment within a specified period. The bank's lending, funding and investment activities give rise to interest rate risk. This is a major component of market risk for the bank, since its primary source of funding is through deposits. These tend to be short to medium-term in nature, whereas the bank's main business, housing finance, generally involves long-term lending. The bank operates in a predominantly fixed-rate lending environment while the majority of its liabilities are subject to frequent re-pricing. Increased interest cost during the year has significantly affected the margin and the bank is considering strategies to address this mismatch.

Several new assets and liability products were introduced during the year to match the mismatches and to be aligned with customer needs and market conditions.

RISK MANAGEMENT CONTD...

SMIB will introduce floating interest rate for long term lending in 2013.

More generally, the ALCO manages the potential impact of market rate volatility and yield curve changes to minimize any negative impact on net interest income.

Liquidity Risk

Liquidity risk is the potential for loss to an institution arising from either its inability to meet its obligations or to fund increases in assets as they fall due without incurring unacceptable cost or losses. Liquidity risk cannot be seen in isolation, because it often triggered by consequence of other financial risks such as credit risk and market risk.
Liquidity management is of vital importance to SMIB due to the nature of its assets and liabilities profile. Through identified ratios bank monitors the composition of assets and liabilities, diversification and stability of liabilities while more focusing on improving the quality of credit portfolio.

The Bank also won depositor confidence through the fair and competitive deposit rates it offered and the accessibility to retail deposits has increased through increased branch network. Hence reliance on wholesale deposits has reduced. Lack of long-term borrowing instruments at affordable costs results in maturity mismatch in the asset book and the bank is researching on introducing innovative products to reduce the maturity mismatch.

The bank monitors a number of liquidity ratios as per the CBSL risk direction which are discussed at ALCO and Board Integrated Risk Management Committee.

The bank monitors its own liquidity movements through regular cash flow forecasts, liquidity ratio and maturity gap analysis. The bank also analyses the contingency funding plan and the market accessibility.

The ALCO, as the bank's primary arbiter of lending and deposit rates, increased the frequency of its formerly meeting schedule in order to deal more expediently with the volatile market conditions.

The bank comfortably meets the regulatory requirements relating to liquidity.

Ratio	31/12/2012	31/12/2011
Net loans/Total assets	81.9168575	78.8446323
Loans/Customer Deposits	106.4653194	107.1740644
Liquid Assts/Short term Liabilities	21.98	20.04

(Liquid assets include cash and short term funds and short term investments. Short term liabilities include savings deposit, repo borrowings and current taxation)

Stress testing is being carried out at frequent intervals to measure the resilience of its portfolio to liquidity variation and expected adverse scenarios.

Operational Risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and system or from external events. Operational risk is associated with human error, system failures and inadequate procedures and controls.

The bank mitigates operational risk by improving policies, technology infrastructure and streamlining procedures and controls. SMIB has a comprehensive operational risk management policy in place which covers risk identification, assessment, implementation of controls, monitoring and reporting mechanism. Main operations are separately guided by the board approved manuals like Credit and Operations Manuals. The bank is involved in a continuing process of systems development and improvement. This subsumes the improvement of controls through IT system, preventive maintenance, skill development of employees, timely introduction and application of procedures and policies and use of risk transfer measures. Reviews of operations and activities are undertaken at regular meetings.

Employees are trained in order to acquaint them with the correct operational procedures pertinent to their functions, emphasizing their responsibility to comply at all times with these procedures.

RISK MANAGEMENT CONTD...

Operational risk events are reported to risk management department by appointed officers in each functional unit. Audit findings, reconciliation process, and branch visits, sample base reviews carried out by operational risk management function of the bank also feed information to risk identification process.

A loss tracking database has been designed where the loss incidents will be collected and analyzed based on business function. Theses information will be analyzed to propose preventive measures on the lessons learnt.

Immediate procedural steps are taken to prevent any repetition when a shortcoming in the processes is detected. Actions are taken to improve transparency in business activities, controls and policies, ensuring smooth and sound operations. Both external and internal auditors monitor the degree of the compliance of operational activities with the appropriate policies of the bank.
The bank has initiated actions on investing on upgrading the information system and the management information system to strengthen the internal control system, provide efficient service and facilitate accurate decision making. The bank is committed to aggressively penetrate market share in alternative delivery channels and making necessary investment in people, structure and system to ensure competitive advantage.

Legal Risk

Legal risk arises from unenforceable transactions in a court of law or the failure to successfully defend legal action instituted against the bank. Bank's existing legal team takes necessary precautions in such events and takes immediate action to address and mitigate these risks. If required the bank will obtain external legal advice to overcome the legal risk to be faced by the bank.

Strategic Risk Management

Strategic risk is the possibility of current and prospective impact on earnings or capital arising from adverse business decisions, improper implementation of decisions, or lack of responsiveness to industry changes.

Board of directors and the General Manager together with the corporate management conducts the strategic plan and is communicated down the line for proper implementation. All strategic decisions taken by the Board and the corporate management are given due consideration to regulatory requirement, applicable laws and regulations, corporate governance requirements, ethics and industry best practices to improve the standards of decisions and to mitigate risk.

Compliance Risk

This is the loss that the bank may suffer due to non-compliance with the applicable laws, regulations, and codes of conduct and standards of good practices. SMIB has initiated the compliance function within the bank and a compliance manual has been approved by the board of directors. The compliance function works closely with business and operational units to ensure the consistent management of compliance risk.

CORPORATE GOVERNANCE

The source of strength of SMIB in maintaining the stability it has reached now is mainly due to its Professional approach and dedicated service towards its customers.

The main objective of the Bank its to provide financial assistance and advice to Agriculture, Housing and Industrial sectors and promote Savings Mobilizations in accordance with Act No13 of 1975 and subsequent amendment Nos.62 of 1981, 29 of 1984 and 10 0f 1994.

Transparency and accountability is diligently maintained by SMIB to strike balance between economy and social goals, thus up holding the concept of good governance which was introduced under Banking Act direction No.12 of 2007 for licensed specialized Banks of Sri Lanka.

In implementing the corporate governance within SMIB, the Board of Directors had taken every possible attempt to comply with the applicable accepted practice and procedure.

Board of Directors

The Board is collectively responsible for the efficient operation and success of the Bank by directing and supervising the Bank's affairs.

One of the main aim of the Board of Directors is to ensure the smooth and efficient functioning of corporate governance of the Bank.

The Board of Directors are responsible and accountable for the overall operation and Financial stability of the Bank and it's resolute strategy and accuracy while adhering to statutory requirements of the Bank.

The Board of Directors consists of nine directors appointed by the Minister of Finance. The Directors of the Board are selected from personal who have extensive knowledge and experience in Sociology, Finance, Legal, and Commercial fields. The balance of skill and experience required to make inevitable changes to reflect the current needs of the Bank which is essential to make it an effective decision making body.

Hon. Minister is empowered to appoint a Chairman among the directors.

The Chairman should provide leadership to the Board affairs and ensure that the Board works effectively, discharging its responsibilities, ensuring that all key and appropriate issues are discussed by the Board in time. All Directors are properly briefed by the Chairman on issues arising at Board meetings and the Directors make a full and active contribution toward the development of the Bank.

Board Meetings

The Board meetings are held at least once a month , while special Board meetings are held as and when the need arises. The Board meetings are held on prior notice.

The Directors are provided with all required information and given adequate time so that they could go through all documents and make correct decisions.

It's main objective is to maintain Bank's strategic and corporate value and to ensure that the affairs and proposals related to the promotion of business and management are undertaken properly.

Matters mainly considered at these meetings include approving or reviewing of corporate Strategy, Budgetary operations, Financial performance, Delegation of Authority and Approving loans.

Twelve Board meetings were held during the year 2012 and the minutes of the Board are maintained by the Secretary to the Board in accordance with the rules and regulations .

The Functions of the General Manager

The General Manager is the Chief Executive Officer of the Bank. He is bound to perform all acts directed by the Board , specially or generally authorized in writing.

The management and operational activities of the Bank has been delegated to the General Manager who heads the Corporate Management team in line with the Board approved strategic objectives, Corporate Values, Overhaul Risk Policy and Risk Management procedure in a very confidential manner.

Sub Committees

There are several Board Sub committees, with a defined

CORPORATE GOVERNANCE CONTD...

scope of work and term of reference. These Committees are responsible for providing expert advice to the Board on the subjects assigned.

Also these committees are chaired by Directors who have experience in the relevant subject and who work independently.

In view of the Corporate Governance to ensure that the Bank's oversees control affairs are functioning smoothly .the Board has appointed several Sub Committees to focus on Audit, Credit, Human Resources & Remuneration Management, Assets and Liability (ALCO) and Risk Management.

The Board subcommittee meetings are held regularly in accordance with the regulatory requirement and the needs of the Bank

Audit Committee

The Audit Committee, comprises of Four Directors of the Bank with the Chief Internal Auditor functioning as the Secretary. The General Manager, DGM (Finance), DGM(Credit), Chief Risk Officer and AGM (Finance) attend the Committee Meetings on invitation. The Audit Committee, which is constituted in accordance with the provision of the Public Enterprise Guidelines for best Governance is accountable to the Board.

The Audit Committee is authorized to determine the scope of the Internal Audit unit, review the Management letters, consider contents of Internal Audit reports, examine the adequacy and effectiveness of internal control systems, review the statutory accounts and published Financial Statements, assess compliance with regulatory requirements, review, performance including budgetary reports and review the implementation of the recommendations of the Committee on Public Enterprises (COPE) , Four (04)meetings were held during the year 2012

Executive Credit Committee

The Executive Credit Committee headed by the General Manager, comprises of DGM/AGM(Credit), DGM (Finance, Planning &Administration), Assistant General Manager Credit & AGM Recoveries. AGM- Legal and AGM-Valuation attend the Committee meetings on invitation. This committee formulates the Bank's Credit Policy and monitors the Management of Credit Risk.

Facilities over and above the delegated authority of the Management are also referred to this Committee for approval. Thirty Two (32) meetings were held during the year 2012 .

Human Resources Remuneration Committee

The above committee was constituted according to the corporate Governance direction which came into effect on 01.01.2008.

It comprises of Three Directors. AGM (Legal) functions as the Secretary, GM and AGM (P&A) attend the meetings on invitation.

The said Committee function in accordance with the regulations of the Board & Guideline issued by the Central Bank. It is authorized to determine the remuneration policy, evaluate performances, introduce, monitor and review the development & Human Resource Performance. Four (04) meetings were held during the year 2012.

Assets & Liabilities Management Committee

The main function of the Assets & Liabilities Committee (ALCO) is to monitor the assets and liabilities of the Bank and then assess and manage the risk involved.

The ALCO is headed by the General Manager and consists of the Deputy General Manager (Finance) Deputy General Manager (Credit) Chief Risk Officer, Assistant General Manager (Finance) and AGM (IT) with Treasury Executive as the Secretary .The ALCO's authority is delegated by the Board of Directors.

The Committee functions as a top operational unit, managing the balance sheet within the parameters laid down by the Board meeting. Seven meetings were held during the year 2012.

Management Committee

Corporate Management is responsible for the day -to day operations of the Bank, working within the controlled environment and framework set out by the

CORPORATE GOVERNANCE CONTD...

Board of Directors. The Management Committee is headed by the General Manager and comprises of senior management above Chief Manager grade. The Branch Managers participate in this meeting once a month, along with the management committee. It meets regularly to discuss the performance regarding targets, opportunities, issues and current developments.

Seven (07) meetings were held during the year 2012.

Ethics

The Bank requires all Directors, Higher Management, Middle Management and Employees to maintain the highest standards of integrity and honesty in performing their duties. Following are the key measures adopted by the Board to create a strong ethical culture.

- We will not risk the Bank's reputation by knowingly associating with people, organizations, products or transactions that could potentially damage our reputation
- We are positive about complying with our legal and regulatory obligations. This protects our stakeholders and ourselves
- Each member of the staff has a personal responsibility to contribute towards the Bank's success and reputation by carrying out his or her job conscientiously, efficiently and honestly, and maintaining the highest standard of integrity and personal conduct in all matters.
- We encourage the means whereby staff can report any suspicions of wrongdoing to senior management.
- Consistent with the highest standards of integrity, we do not approve of the solicitation or acceptance of hospitality of gifts, which may be mistaken for an inducement. We also do not approve the use of information received in the course of our business dealings, for personal gain.
- We seek business relationships, which are mutually beneficial and lead to success through fair dealing and high standards of business integrity.
- We will normally seek competitive proposals from suitable suppliers and service providers.
- We acknowledge responsibility for all employee related issues, including health and safety.
- *We encourage employees to develop a lifestyle which integrates both work and family.
- *We believe it is important for all staff to be able to share the benefits of good performance by the Bank.
- The Bank encourages employees to adopt a responsible attitude to work, with explicable self imposed discipline. The main aim of the Bank's discipline policy is to be corrective rather than punitive and it is in line with governmental regulations. It sets reasonable standards of performance and behaviour and aims to ensure consistency and fairness of treatment of all employees.
- We aim to lend with responsibility and base our credit decisions on a thorough understanding of the customer.
- We seek a clear link between equality, diversity and business excellence.

විගණකාධිපති දෙපාර්තමේන්තුව
கணக்காய்வாளர் தலைமை அதிபதி திணைக்களம்
AUDITOR GENERAL'S DEPARTMENT

මගේ අංකය / எனது இல / My No. FB/E/SMIB/FA/2012
ඔබේ අංකය / உமது இல / Your No.
දිනය / திகதி / Date 21st August 2013

The Chairman,
State Mortgage and Investment Bank.

Auditor General's Report of Factual Findings of State Mortgage and Investment Bank to the Board of Directors of the State Mortgage and Investment Bank on the compliance requirement of the Corporate Governance Direction issued by the Central Bank of Sri Lanka.

I have performed the producers enumerated in Annexure to the report, with respect to the Corporate Governance Report of the Board of Directors prepared and presented to meet the compliance requirement of the Corporate direction issued by the Central Bank of Sri Lanka (CBSL). This engagement has been performed in accordance with the principles set out in Sri Lanka Standard on Related Services 4400 (SLSRS 4400) applicable to agreed-upon producers engagements. The procedures were performed solely to assist you to meet the compliance requirement of the corporate governance directive. To perform this agreed upon procedures, I was assisted by a firm of Charted Accounts in public Practice.

I report my findings in the attached Annexure to this report.

Because the above procedures do not constitute an audit or a review made in accordance with Sri Lanka Auditing Standards, I do not express any assurance on the compliance with the directives of corporate governance issued by CBSL.

Had I performed additional procedures or had I performed an audit or a review of the Financial Statements in accordance with Sri Lanka Auditing Standards, other matters might have come to my attention that would have been reported to you.

My report is slowly for the purpose set forth in the first paragraph of this report and for your information and is not to be used for any other purpose or to be distributed to any other parties. This report relates only to the items specified above and does not extend to any financial statement of State mortgage and Investment Bank, taken as a whole.

H.A.S Samareweera
Auditor General

අංක 306/72 පොල්දූව පාර, බත්තරමුල්ල , ශ්‍රී ලංකාව
இல. 306/72, பொல்துவ வீதி, பத்தரமுல்லை இலங்கை
No.306/72, Polduwa Road, Battaramulla , Sri Lanka

දුරකථනය / தொலைபேசி / Telephone. 2887028 /034
ෆැක්ස් අංකය / பக்ஸ் இல / Fax No. 2887223
ඉලෙක්ට්‍රොනික් තැපැල් / ஈ- மெயில் / E-mail. oaggov@sltnet.lk

CORPORATE GOVERNANCE CONTD...

Annexure to the Report on Factual Findings

NOTE: The below mentioned numbering is used to coincide with the "section 3" of the Banking Act Direction No. 11 of 2007 issued by the Central Bank of Sri Lanka, the sections 1 & 2 are not applicable for this document.

Sec.	Procedure Performed	Complied	Not Complied	N/A	Reference
3(1) 3(1)(i)	The Responsibilities of the Board Agreed upon procedures carried out to ensure the board has strengthened the safety and soundness of the bank. a) Checked the board approval, the bank's strategic objectives and corporate values.	Complied			Observed the revised Strategic Plan for 2009-2013. Approved by the Board (B/P No. 03/04/2009). This is the most recent document available which was approved by the board.
	Checked whether the bank has communicated the bank's strategic objectives and corporate values throughout the bank.	Complied			Strategic objectives and corporate values are communicated through head of departments at each division.
	b) Checked the board approval of the overall business strategy of the bank.	Complied			Overall business strategy included in the corporate plan and it was approved by the board by the B/P No.03/04/2009.
	Checked that the overall business strategy that includes the overall risk policy, risk management procedures and mechanisms and they are documented.	Complied			The bank has documented goals to improve the risk management of the bank and observed that it was included in the corporate plan.
	Checked that the overall business strategy contains measurable goals, for at least the next three years.	Complied			Observed that the measurable goals for 2009 to 2013 are included in the revised strategic plan.
	c) Checked that the appropriate systems to manage the risks identified by the board are prudent and are properly implemented.	Complied			"Board Integrated Risk Management Committee" has addressed the risk identified periodically. Observed the board minutes & board papers. Eg. Board Minute No 3 & 5 B/P No. 12/03/18 & 12/5/11
	d) Checked that the board has approved and implemented a policy of communication with all stakeholders, including depositors, creditors, shareholders and borrowers;	Complied			The Customer Charter is used for this purpose.

CORPORATE GOVERNANCE CONTD...

Sec.	Procedure Performed	Complied	Not Complied	N/A	Reference
	e) Checked that the board has reviewed the adequacy and the integrity of the bank's internal control systems and management information systems;	Complied			The adequacy and integrity of the internal controls & management information System had been reviewed by the Board Audit Committee. (Observed board audit committee minutes) and the board reviewed the respective BAC papers in the board meetings. (Referred B/P No. 12/4/06, B/P 12/9/11, B/P 12/09/13)
	f) Checked that the board has identified and designated key management personnel, as defined in the Sri Lanka Accounting Standards, who are in a position to: (i) significantly influence policy; (ii) direct activities; and (iii) exercise control over business activities, operations and risk management;	Complied			The board designated kMP's as defined by SLAS 30, according to the annual report 2011 and they appointed into separate committees and by those committees' direct activities and exercised controls over the bank.
	g) Checked that the board has exercised appropriate oversight of the affairs of the bank by key management personnel, that is consistent with board policy;	Complied			The board oversees the affairs of the bank through the appointed committees and the financial performance review. Basically this is done by the Board Audit Committee and checked the BAC papers. B/P 12/04/06
	h) Checked that the board has defined the areas of authority and key responsibilities for the board directors themselves and for the key management personnel;	Complied			As we observed, there are no documented key responsibilities to each director. But directors were allocated to sub committees. So it is obvious that they have still key responsibilities as their capacity. Further, the directors powers and authority defined in SMIB Law No.13 of 1975 as the Section 07.
	i) Checked that the board has periodically assessed the effectiveness of the board directors' own governance practices, including: (i) the selection, nomination and election of directors and key management personnel; (ii) the management of conflicts of interests; and (iii) the determination of weaknesses and implementation of changes where necessary.		Not Complied		Selections, nominations and election of the board of directors are done by the finance minister according to the SMIB Law No.13 of 1975. However, board has not assessed the effectiveness of the board directors' own governance practices in the year 2012.
	j) Checked that the board has a succession plan for key management personnel.	Complied			Suitable personnel have been identified in the succession plan for most of the key positions. Board paper No. 12/02/16 and minute No 2.

CORPORATE GOVERNANCE CONTD...

Sec.	Procedure Performed	Complied	Not Complied	N/A	Reference
	k) Checked that the board has scheduled regular meetings with the key management personnel to review policies, establish communication lines and monitor progress towards corporate objectives.	Complied			It is required according to the SMIB Law Section 15, the board should hold atleast once a month a board meeting. Accordingly the board has met 12 times during the year 2012.
	l) Checked that the board has taken measures and processes in place to understand the regulatory environment and that the bank maintains a relationship with regulators.	Complied			The Board Audit Committee assists the bank in this regard as per the charter of audit committee and it was evidenced that they have done it by reviewing BAC papers. Further, there is a separate compliance officer in the bank who represents the bank in this regard.
	m) Checked that the board has a process in place for hiring and oversight of external auditors.			N/A	This procedure is in accordance with the requirement of the SMIB Law No.13 of 1975.
3(1) (ii)	Checked that the board has appointed the chairman and the Chief Executive Officer (CEO).	Complied			The chairman has been appointed by the Finance Minister.(SMIB Law No.13 of 1975 Section 14)
	Checked that the functions and responsibilities of the chairman and the CEO are in line with Direction 3(5) of these Directions.	Complied			Please refer the result observed under direction 3 (5) of the direction.
3(1) (iii)	Checked that the board has met regularly and held board meetings at least twelve times a year at approximately monthly intervals.	Complied			Checked the board minutes and board has met 12 times for the period of 2012 and further, observed the director's attendance book.
3(1) (iv)	Checked that the board has a procedure in place to enable all directors to include matters and proposals in the agenda for regular board meetings where such matters and proposals relate to the promotion of business and the management of risks of the bank.	Complied			The agenda prepared under the authority of the board secretary and it is checked by the CEO/GM. All directors shall have unlimited access to advice and for the service of the company Secretary. Accordingly matters and proposals relate to the promotion of bank are discussed by the board of directors.
3(1) (v)	Checked that the board has given notice of atleast 7 days for a regular board meeting to provide all directors an opportunity to attend. And for all other board meetings, notice has been given.	Complied			The prepared agenda was sent to each of board of directors which is signed and approved by the secretary to the board by post and by hand before 7 days for the meeting.

CORPORATE GOVERNANCE CONTD...

Sec.	Procedure Performed	Complied	Not Complied	N/A	Reference
3(1) (vi)	Checked that the board has taken required action on directors who have not attended atleast two-thirds of the meetings in the period of 12 months immediately preceding or has not attended the immediately preceding three consecutive meetings held. Participation at the directors' meetings through an alternate director, however, to be acceptable as attendance.	Complied			The directors have attended the meetings as required. Observed the "Directors' Attendance Sheets".
3(1) (vii)	Checked that the board has appointed a company secretary who satisfies the provisions of Section 43 of the Banking Act No. 30 of 1988, and whose primary responsibilities shall be to handle the secretariat services to the board and shareholder meetings and carry out other functions specified in the statutes and other regulations.	Complied			According to the section 43 of the Banking Act No. 30 of 1988 and the companies act No 7 of 2007 the secretary to the board is appointed who is an attorney at law Mrs. P. A. C. K Amarasinghe holds the office.
3(1) (viii)	Checked the process to enable all directors to have access to advice and services of the company secretary.	Complied			All directors shall have unlimited access to advice and for the service of the company secretary.
3(1) (ix)	Checked that the company secretary maintains the minutes of board meetings and there is a process for the directors to inspect such minutes.	Complied			Observed that all the minutes of the board meetings are filed sequentially and kept under the board secretaries' authority. At any time any director shall have access to any information regarding the board meetings.
3(1) (x)	Checked that the minutes of a board meeting contained or refer to the following: a) a summary of data and information used by the board in its deliberations b) the matters considered by the board c) the fact-finding discussions and the issues of contention or dissent which may illustrate whether the board was carrying out its duties with due care and prudence; d) the matters which indicate compliance with the board's strategies and policies and adherence to relevant laws and regulations; e) the understanding of the risks to which the bank is exposed and an overview of the risk management measures adopted; and f) the decisions and board resolutions.	Complied			Information required under this regulation is included in the board minutes maintained. Following included the normal contents of the board minutes of the bank. i) Minutes for the confirmation. ii) Matters arising out of the minutes of the previous meetings. iii) Differed from the previous meeting iv) Recovery matters v) Financial matters vi) Marketing and publication matters vii) Administration and personal matters. viii) Credit matters ix) Risk Matters x) Legal Matters xi) Any Other Matters.

CORPORATE GOVERNANCE CONTD...

Sec.	Procedure Performed	Complied	Not Complied	N/A	Reference
3(1) (xi)	Checked that there are procedures agreed by the board to enable directors, upon reasonable request, to seek independent professional advice in appropriate circumstances, at the bank's expense.		Not complied		Agreed procedures to seek independent professional advice were not observed.
3(1) (xii)	Checked that there is a procedure to determine, report, resolve and to take appropriate action relating to directors avoid conflicts of interests, or the appearance of conflicts of interest.	Complied			For this it followed the SMIB Law No.13 of 1975 section 17. Further the act provide that, no loan shall be granted by the bank to any director or employee of the bank or to the spouse or a dependent child of a director or employee or to any company or firm in which a director or employee has a substantial interest. (Please refer the annual report 2011 page No. 76)
	Checked that a director has abstained from voting on any board resolution in relation to which he/she or any of his/her close relation or a concern in which a director has substantial interest, is interested.	Complied			There's no disclosure of interest made in the minutes during the year 2012 as it is required by the SMIB Law No.13 of 1975 section 17 to disclose the interest in the minutes if any. And as per the explanation of the CIA and the secretary to the board there was no conflict of interest of the board as they all are independent non executive directors in the board.
	Checked that has he/she been counted in the quorum for the relevant agenda item at the board meeting.	Complied			Such a person has not been counted in the quorum.
3(1) (xiii)	Checked that the board has a formal schedule of matters specifically reserved to it for decision to identify the direction and control of the bank is firmly under its authority.	Complied			There is a formal schedule maintained by the board. Checked the board minutes.
3(1) (xiv)	Checked that the board has forthwith informed the Director of Bank Supervision of the situation of the bank prior to taking any decision or action, if it considers that the procedures to identify when the bank is, or is likely to be, unable to meet its obligations or is about to become insolvent or is about to suspend payments due to depositors and other creditors.			N/A	As we observed, such a situation has not been evident through the review of the board minutes or draft financial statements of 2012.

CORPORATE GOVERNANCE CONTD...

Sec.	Procedure Performed	Complied	Not Complied	N/A	Reference
3(1) (xv)	Checked that the board has the bank capitalized at levels as required by the monetary board.	Complied			The required capital adequacy ratio as per the CBSL is 10% and 31/12/2012 the SMIB shows capital adequacy (Tear 1) 26.68% and Total capital ratio is 26.99%. We observed capital adequacy ratio calculation documents for 4th quarter in 2012 which was sent to CBSL.
3(1) (xvi)	Checked that the board publishes, in the bank's annual report, an annual corporate governance report setting out the compliance with direction 3 of these directions.	Complied			A report on corporate governance has been published in the 2011 annual report. The same practice will be continued in the 2012 annual report as well. Draft of 2012 CG report has been referred in this regard.
3(1) (xvii)	Checked that the board adopts a scheme of self-assessment to be undertaken by each director annually, and maintains records of such assessments.		Not complied		Self assessment process has not been carried out by the board of directors for the year 2012.
3(2) 3(2)(i)	The Board's Composition Checked that the board comprise of not less than 7 and not more than 13 directors.	Complied			The board consists of 8 directors and two were newly appointed during the year. Observed the board attendance book and appointment letter of directors which is sent by ministry of finance and planning.
3(2) (ii)	(A) Checked that the total period of service of a director other than a director who holds the position of CEO, does not exceed nine years.	Complied			As we observed that directors have not exceeded 9 years of services in the capacity of directors. Observed the directors correspondence files.
	(B) In the event of any director serving more than 9 years, check that the transitional provisions have been applied with.			N/A	As we observed above, no directors have exceeded 9 years in the capacity of directors.
3(2) (iii)	Checked that the number of executive directors, including the CEO does not exceed one-third of the number of directors of the board.	Complied			All Directors are Non – Executive and appointed by the Minister of Finance under the SMIB Law 13 of 1975 Section 7
3(2) (iv)	Checked that the board has at least three independent non-executive directors or one third of the total number of directors, whichever is higher.	Complied			All directors are non – executives and appointed by the finance minister.

CORPORATE GOVERNANCE CONTD...

Sec.	Procedure Performed	Complied	Not Complied	N/A	Reference
	Checked if non-executive directors can be considered independent if he/she:			N/A	
	a) Holds a direct and indirect shareholdings of more than 1 per cent of the bank;			N/A	There's no any share holding by the director as the bank fully owned by the government.
	b) currently has or had during the period of two years immediately preceding his/her appointment as director, any business transactions with the bank as described in Direction 3(7) hereof, exceeding 10 percent of the regulatory capital of the bank.			N/A	There's no business transaction which exceeds 10% of the regulatory capital as per 2012 draft accounts.
	c) has been employed by the bank during the two year period immediately preceding the appointment as director.			N/A	There's no such non executive director who were employed by the bank.
	d) has had a close relation; who is a director, CEO, a member of key management personnel, a material shareholder of the bank or another bank. (For this purpose, a "close relation" means the spouse or a financially dependent child)			N/A	Appointments of directors are done by minister of finance .And We also did not observe such matters based on the declaration to be submitted in terms of Section 42 of the banking act which provided by each of directors.
	e) represents a specific stakeholder of the bank				
	f) is an employee or a director or a material shareholder in a company or business organization:			N/A	No shareholder as the bank is fully owned by the government.
	I. which currently has a transaction with the bank as defined in Direction 3(7) of these Directions, exceeding 10 per cent of the regulatory capital of the bank, or			N/A	Checked the annual report of year 2011 and there is no business transaction which is exceeding 10% of the regulatory capital of the bank and as per the explanation given, there are no such transactions.
	II. in which any of the other directors of the bank are employed or are directors or are material shareholders; or			N/A	No incident was observed in this regard.
	III. in which any of the other directors of the bank have a transaction as defined in Direction 3(7) of these Directions, exceeding 10 per cent of regulatory capital in the bank.			N/A	

CORPORATE GOVERNANCE CONTD...

Sec.	Procedure Performed	Complied	Not Complied	N/A	Reference
3(2) (v)	In the event an alternate director was appointed to represent an independent director, Checked the person so appointed meet the criteria that applies to the independent director.			N/A	No alternative directors were appointed during the year as per the board secretary's explanations.
3(2) (vi)	Checked that the bank has a process for appointing independent directors.	Complied			Appointments of directors are done by the minister of finance under the SMIB Law No.13 of 1975.(Section 07)
3(2) (vii)	Checked that the stipulated quorum of the bank includes more than 50% of the directors and out of this quorum more than 50% should include nonexecutive directors.	Complied			Required quorum is 3 members as the SMIB Law (Section 16) and all directors are non –executives and the quorum consist of more than 50% of the directors.
3(2) (viii)	Checked that the bank discloses the composition of the board, by category of directors, including the names of the chairman, executive directors, nonexecutive directors and independent non-executive directors in the annual corporate governance report.	Complied			Checked the annual report of year 2011 and the bank has disclosed the composition of the board in the CG report. (page 26,27 of the Annual Report 2011 for the CG report)
3(2) (ix)	Checked the procedure for the appointment of new directors to the board.	Complied			The appointment of directors is done by the minister of finance under SMI Bank Act.(Section 07)
3(2) (x)	Checked that all directors appointed to fill a casual vacancy be subject to election by shareholders at the first general meeting after their appointment.	Complied			The directors are appointed by the finance minister in compliance with the Act. During the year two directors have been appointed as new directors. (Mr. S.L.G. Bandusiri & Mr. P.H.L.W. Perera)
3(2) (xi)	Checked if a director resigns or is removed from office, the board: a) announce the director's resignation or removal and the reasons for such removal or resignation including but not limited to information relating to the relevant director's disagreement with the bank, if any; and	Complied			The removal of the directors is also done by the finance ministry. During the year (Mrs. K. D. L Kandanaarachchi & Mr. S. M. G. Jayaratna) have resigned. (09/03/2012). Checked the resignation letters.
	b) issue a statement confirming whether or not there are any matters that need to be brought to the attention of shareholders.			N/A	Minute No 2. There's no statement issued in this regard.
3(2) (xii)	Checked if there is a process to identify whether a director or an employee of a bank is appointed, elected or nominated as a director of another bank.	Complied			There's no any director or employee elected or nominated as a director of another bank. We observed the declaration which was submitted in terms of section 42 of the banking act which was provided by each of the directors.

CORPORATE GOVERNANCE CONTD...

Sec.	Procedure Performed	Complied	Not Complied	N/A	Reference
3(3) 3(3)(i)	Criteria to Assess the Fitness and Propriety of Directors Checked that the age of a person who serves as director does not exceed 70 years.	Complied			Checked the correspondence file of the directors and there is no director who exceed the age of 70 years.
	(A) Checked that the transitional provisions have been complied with.			N/A	Based on the above result, no such directors.
3(3)(ii)	Checked if a person holds office as a director of more than 20 companies/entities/ institutions inclusive of subsidiaries or associate companies of the bank.	Complied			Checked the correspondence files of the directors and declaration to be submitted in terms of section 42 of the banking act. Accordingly, there's no such director who holds office as a director in more than 20 entities.
3(4) 3(4)(i)	Management Functions Delegated by the Board Checked that the delegation arrangements have been approved by the board.	Complied			Power delegation by the BOD to manage the business to the general manager done according to the SMIB Law-section 20, 21. Other than that the board appointed sub committees and delegate power accordingly.
3(4)(ii)	Checked that the board has taken responsibility for the matters in 3 (1) (i) even in the instances such actions are delegated.	Complied			Through review of minutes it was noted that the board has discussed matters in a responsible manner and therefore all the sub committees ultimately report to the BOD.
3(4)(iii)	Checked that the board review the delegation processes in place on a periodic basis to ensure that they remain relevant to the needs of the bank.	Complied			The board reviewed the delegation process on a periodic basis. Checked internal letters and circulars in this regard. B/P 12/09/16
3(5) 3(5)(i)	The Chairman and CEO Checked that the roles of Chairman and CEO are separate and not performed by the same individual.	Complied			Roles of the chairman and CEO are separate and not performed by the same individual. Chairman – Mr. Jagath Wellawatta CEO/GM –Mr. N. M. Dayasinghe.
3(5)(ii)	Checked that the chairman is a non-executive director. In the case where the chairman is not an independent director, check that the board designate an independent director as the senior director with suitably documented terms of reference. Checked that the designation of the senior director be disclosed in the bank's annual report.	Complied		 N/A N/A	Chairman is a non –executive director and he is appointed by the finance minister under the SMIB Law No.13 of 1975. N/A N/A

CORPORATE GOVERNANCE CONTD...

Sec.	Procedure Performed	Complied	Not Complied	N/A	Reference
3(5) (iii)	Checked that the board has a process to identify and disclose in its corporate governance report, which shall be a part of its annual report, any relationship [including financial, business, family or other material/ relevant relationship(s)], if any, between the chairman and the CEO and board members and the nature of any relationships including among members of the board.	Complied			This has been disclosed in the self declaration made by the directors in accordance with the CBSL requirements. Checked those self declaration and the annual report -2011 disclosures in this regard.
3(5) (iv)	Checked that the board has a self evaluation process where the chairman: a) provides leadership to the board; b) ensures that the board works effectively and discharges its responsibilities; and c) ensures that all key and appropriate issues are discussed by the board in a timely manner.		Not complied		During the year there is no such self evaluation which is reviewed by the board.
3(5) (v)	Checked that a formal agenda is circulated by the company secretary approved by the chairman.		Not complied		The agenda which was circulated to each and every director was prepared by the board secretary. But we noted that the approval of the chairman has not been given.
3(5) (vi)	Checked that the chairman ensures, through timely submission that all directors are properly briefed on issues arising at board meetings.	Complied			Checked the board minutes and the board papers. The directors are properly briefed on issues arising at the board meetings
3(5) (vii)	Checked that the board has a self evaluation process that encourages all directors to make a full and active contribution to the board's affairs and the chairman taking the lead to act in the best interest of the bank.		Not complied		Proper procedures were not observed regarding this.
3(5) (viii)	Checked that the board has a self evaluation process that assesses the contribution of non-executive directors.		Not complied		Proper procedures were not observed regarding this.
3(5) (ix)	Checked that the chairman does not engage in activities involving direct supervision of key management personnel or any other executive duties whatsoever.	Complied			The chairman does not engage in activities involving direct supervision of key management personnel or any other executive duties whatsoever.
3(5) (x)	Checked that there is a process to maintain effective communication with shareholders and that the views of shareholders are communicated to the board.	Complied			As we observed, representative of share holder (Government representative - Mr. V. M. Ameen) attends to each and every board meetings. We observed the attendance with referring to the board minutes.

CORPORATE GOVERNANCE CONTD...

Sec.	Procedure Performed	Complied	Not Complied	N/A	Reference
3(5) (xi)	Checked that the CEO functions as the apex executive-in-charge of the day to day management of the bank's operations and business.	Complied			Actively participated through board meetings and board sub committees to the operations of the bank.
3(6) 3(6)(i)	Board Appointed Committees Checked that the bank has established atleast four board committees as set out in Directions 3(6)(ii), 3(6)(iii), 3(6)(iv) and 3(6)(v) of these Directions.	Complied			• Board sub Committees are; • Audit Committee • Human Resources, Remuneration and Nomination Committee • Board Integrated Risk Management Committee (BIRMC) • Credit Committee • Management committee. • Assets & Liabilities Management Committee.
	Checked that each board committee report is addressed directly to the board.	Complied			Each board sub-committee report is directly addressed to the board. Observed the report of such board committees.
	Checked that the board presents in its annual report, a report on each committee on its duties, roles and performance.	Complied			Checked the annual report of year 2011. This is complied.
3(6) (ii)	Audit Committee: a) Checked that the chairman of the committee is an independent non-executive director and possesses qualifications and related experience.	Complied			The chairman is a independent non-executive director. The chairman of the board audit committee has necessary qualifications and experience. (Associate member of The Institute of Chartered Accountants of SriLanka & has over 25 years' experience in Finance & Management).

CORPORATE GOVERNANCE CONTD...

Sec.	Procedure Performed	Complied	Not Complied	N/A	Reference
	b) Checked that all members of the committee are non-executive directors.	Complied			There are 5 non executive directors of the board audit committee. New appointment B/P 12/08/28 & Minute No 8.
	c) Checked that the committee has made recommendations on matters in connection with:				
	i. the appointment of the external auditor for audit services to be provided in compliance with the relevant statutes;			N/A	The external auditor has been appointed by the finance minister and auditor general.
	ii. the implementation of the Central Bank guidelines issued to auditors from time to time;			N/A	The audit committee has no authority to deal with external auditors since they are appointed by the finance minister.
	iii. the application of the relevant accounting standards; and			N/A	On behalf of the committee chief internal auditor and head of finance are responsible in this regard.
	iv. the service period, audit fee and any resignation or dismissal of the auditor; provided that the engagement of the Audit partner shall not exceed five years, and that the particular Audit partner is not re-engaged for the audit before the expiry of three years from the date of the completion of the previous term.			N/A	The external auditor has been appointed by the finance minister according to the SMIB Law. As per such provisions, auditor general is the external auditor.
	d) Checked that the committee has obtained representations from the external auditor's on their independence, and that the audit is carried out in accordance with SLAS.			N/A	The external auditor has been appointed by the finance minister according to the SMIB Law. As per such provisions, auditor general is the external auditor.
	e) Checked that the committee has implemented a policy on the engagement of an external auditor to provide non-audit services in accordance with relevant regulations.			N/A	The external auditor has been appointed by the finance minister according to the SMIB Law. As per such provisions, auditor general is the external auditor.
	f) Checked that the committee has discussed and finalized the nature and scope of the audit, with the external auditors in accordance with SLAS before the audit commences.			N/A	The external auditor has been appointed by the finance minister according to the SMIB Law. As per such provisions, auditor general is the external auditor.

CORPORATE GOVERNANCE CONTD...

Sec.	Procedure Performed	Complied	Not Complied	N/A	Reference
	g) Checked that the committee has a process to review the financial information of the bank, in order to monitor the integrity of the financial statements of the bank, its annual report, accounts and quarterly reports prepared for disclosure, and a process in place to receive from the CFO the following; i. major judgmental areas; ii. any changes in accounting policies and practices; iii. the going concern assumption; and iv. the compliance with relevant accounting standards and other legal requirements, and; v. in respect of the annual financial statements the significant adjustments arising from the audit.	Complied			The bank has reviewed the financial information through the audit committee. Checked board audit committee papers and minutes. 1. BAC–22/08/2012 2. BAC–13/02/2012 3. BAC-02/02/2012 4. BAC-27/11/2012
	h) Checked that the committee has met the external auditors relating to any issue in the absence of the executive management with relation to the audit.			N/A	As per the given explanation, board audit committee has not met the external auditor because there are no such matters arisen during the year.
	i) Checked that the committee has reviewed the external auditor's management letter and the management's response thereto.	Complied			The BAC has discussed the audit related issues and quarries. BAC-20/08/2012

CORPORATE GOVERNANCE CONTD...

Sec.	Procedure Performed	Complied	Not Complied	N/A	Reference
	j) Checked that the committee shall take the following steps with regard to the internal audit function of the bank:				
	I. Review the adequacy of the scope, functions and resources of the internal audit department, and satisfy itself that the department has the necessary authority to carry out its work;	Complied			Checked the terms of reference or the internal audit charter in this regard. B/P 12/04/06
	II. Review the internal audit program and results of the internal audit process and, where necessary, ensure that appropriate actions are taken on the recommendations of the internal audit department;	Complied			We Observed the internal audit program which is approved by BAC 13/02/2012 and results of the internal audit process have been discussed.
	III. Review any appraisal or assessment of the performance of the head and senior staff members of the internal audit department;		Not complied		This has not been carried out by the BAC.
	IV. Recommend any appointment or termination of the head, senior staff members and outsourced service providers to the internal audit function;			N/A	We have not observed such a situation during the year 2012.
	V. Checked that the committee is appraised of resignations of senior staff members of the internal audit department including the chief internal auditor and any outsourced service providers, and to provide an opportunity to the resigning senior staff members and outsourced service providers to submit reasons for resigning;			N/A	
	VI. Checked that the internal audit function is independent of the activities it audits.	Complied			It was noted that the internal audit function is independent according to the provided TOR of IA dept. and internal audit charter page 2 sec. 3.
	k) Checked the minutes to determine whether the committee has considered major findings of internal investigations and management's responses thereto.	Complied			Checked the board audit committee papers; 1. BAC–22/08/2012 2. BAC–13/02/2012 3. BAC-02/02/2012 4. BAC-27/11/2012

CORPORATE GOVERNANCE CONTD...

Sec.	Procedure Performed	Complied	Not Complied	N/A	Reference
	l) Checked whether the committee has had at least two meetings with the external auditors without the executive directors being present.	Complied			Mr. B. W. D. Lasantha – the superintendent of audit on behalf of the auditor general was present in the audit committee meetings of 3rd and 4th.
	m) Checked the terms of reference of the committee to ensure that there is; i) explicit authority to investigate into any matter within its terms of reference; ii) the resources which it needs to do so; iii) full access to information; and iv) authority to obtain external professional advice and to invite outsiders with relevant experience to attend, if necessary.	Complied			Checked the term of reference for the audit committee.
	n) Checked that the committee has met, at least four times and maintained minutes.	Complied			The committee has met 4 times for the period of 2012. Checked the audit committee attendance register and minutes.
	o) Checked that the board has disclosed in the annual report, i) details of the activities of the audit committee; ii) the number of audit committee meetings held in the year; and iii) details of attendance of each individual director at such meetings.	Complied			Checked the annual report for the year 2011 for compliance.
	p) Checked that the secretary of the committee is the company secretary or the head of the internal audit function.	Complied			Mr. K. L. N. A. Perera - The chief internal auditor is the secretary of the board audit committee.
	q) Checked that the "whistle blower" policy covers the process of dealing with; i) The improprieties in financial reporting, internal control or other matters. ii) In relation to (i) the committee shall ensure that proper arrangements are in place for the fair and independent investigation of such matters, and iii) Appropriate follow-up action.		Not complied		There's no Whistle Blower policy.

CORPORATE GOVERNANCE CONTD...

Sec.	Procedure Performed	Complied	Not Complied	N/A	Reference
3(6) (iii)	Checked whether the following rules apply in relation to the Human Resources and Remuneration Committee:				
	a) Checked that the committee has implemented a policy to determine the remuneration (salaries, allowances and other financial payments) relating to directors, CEO and key management personnel of the bank by review of the "Terms of Reference" and minutes.			N/A	Based on circulars of the minister of finance.
	b) Checked that the goals and targets for the directors, CEO and the key management personnel are documented.	Complied			Annual action plan is prepared with targets. Ongoing evaluation is done via management committee meeting.
	c) Checked that the committee has considered evaluations of the performance of the CEO and key management personnel against the set targets and goals periodically and determine the basis for revising remuneration, benefits and other payments of performance-based incentives.		Not complied		Human Resources and Remuneration Committee has not carried out the evaluations of the performance of the CEO and key management personnel against the set targets and goals periodically.
	d) Checked that the "Terms of Reference" provides that the CEO is not present at meetings of the committee, when matters relating to the CEO are being discussed by reviewing the minutes.	Complied			"Terms of Reference" of human resources and remuneration committee stated that CEO is not present at the meeting when matters relate to him are being discussed.
3(6) (iv)	Does the following rules apply in relation to the Nomination Committee:				
	a) Checked that the committee has implemented a procedure to select/ appoint new directors, CEO and key management personnel.			N/A	The directors are appointed by the finance minister as per provisions in the SMIB Act.
	b) Checked that the committee has considered and recommended (or not recommended) the re-election of current directors.			N/A	The directors are appointed by the finance minister.
	c) Checked that the committee has set the criteria such as qualifications, experience and key attributes required for eligibility to be considered for appointment or promotion to the post of CEO, and the key management personnel, by review of job description.		Not Complied		There's no proper procedure in this regard.

CORPORATE GOVERNANCE CONTD...

Sec.	Procedure Performed	Complied	Not Complied	N/A	Reference
	d) Checked that the committee has obtained from the directors, CEO and key management personnel signed declarations that they are fit and proper persons to hold office as specified in the criteria given in Direction 3(3) and as set out in the Statutes.	Complied			Checked that the correspondence files of each of directors and observed that they signed declarations according to the requirement of CBSL.
	e) Checked that the committee has considered a formal succession plan for the retiring directors and key management personnel.	Complied			Formal succession plan submitted to the board under board paper No.12/2/12 & it is reviewed by the board.
	f) Checked that the committee shall be chaired by an independent director and preferably be constituted with a majority of independent directors. The CEO may be present at meetings by invitation.	Complied			All the directors are independent and non- executives directors whom appointed by the finance ministry and CEO/GM has presented to the meeting by invitation.
3(6) (v)	Checked whether the following rules apply in relation to the Integrated Risk Management Committee (IRMC): a) The committee shall consist of at least three non-executive directors, CEO and key management personnel supervising broad risk categories, i.e., credit, market, liquidity, operational and strategic risks and work within the framework of the authority and responsibility assigned to the committee.	Complied			The IRMC consists from three non-executive directors, CEO/GM and other key management personnel on invitation. We observed the IRMC B/P No.12/09/12.
	b) Checked that the committee has a process to assess all risks, i.e., credit, market, liquidity, operational and strategic risks to the bank on a monthly basis through appropriate risk indicators and management information. In the case of subsidiary companies and associate companies, risk management shall be done, both on a bank basis and group basis.	Partially Complied			Checked the document available in this regard in the agenda of Risk Management committee meeting held on 10th September 2012 and it was included the RMC policy which include responsibilities and the authority of the committee. However, we observed this process has not been assessed on a monthly basis.
	c) Checked that the committee has reviewed specific quantitative and qualitative risk limits for all management level committees such as the credit committee and the asset-liability committees, and report any risk indicators periodically.	Partially Complied			Checked the Asset Liability Risk Committees policy. However, only one board minute noted in this regard. B/P No 12/05/19

CORPORATE GOVERNANCE CONTD...

Sec.	Procedure Performed	Complied	Not Complied	N/A	Reference
	d) Checked that the committee has reviewed and considered all risk indicators which have gone beyond the specified quantitative and qualitative risk limits.	Complied			Checked the integrated risk management committee minute. B/P 12/03/18 B/P 12/03/17 B/P 12/07/11 B/P 12/07/12 BIRMC Min. 18/12/2012 BIRMC Min. 18/12/2012 BIRMC Min. 23/10/2012
	e) Checked how many times the committee has met at least quarterly.		Not Complied		We observed that the committee has not met at least quarterly basis and during the year committee has met three times. Dates as follows, 06/09/2012 23/10/2012 18/12/2012 We observed the attendance book of BIRMC for further assurance.
	f) Checked that the committee has reviewed and adopted a formal documented disciplinary action procedure with regard to officers responsible for failure to identify specific risks.		Not Complied		No evidence that the committee acts according to the disciplinary code.
	g) Checked that the committee submits a risk assessment report within a week of each meeting to the board seeking the board's views, concurrence and/or specific directions.		Not Complied		The committee has not submitted the risk assessment report within a week of each meeting.
	h) Checked that the committee has establish a compliance function to assess the bank's compliance with laws, regulations, regulatory guidelines, internal controls and approved policies on all areas of business operations and that there is a dedicated compliance officer selected from key management personnel to carry out the compliance function and report to the committee periodically.	Complied			There is a separate compliance officer for the compliance function. (Mrs. Geeganage) and She reports about the compliance of rules and regulations to the board and to CBSL. BIRMC 2012/BR/01/07

CORPORATE GOVERNANCE CONTD...

Sec.	Procedure Performed	Complied	Not Complied	N/A	Reference
3(7)	Related Party Transactions				
3(7)(i)	Checked that there is a established and documented process by the board to avoid any conflicts of interest that may arise from any transaction of the bank with any person, and particularly with the following categories of persons who shall be considered as "related parties" for the purposes of this Direction: a) Any of the bank's subsidiary companies; b) Any of the bank's associate companies; c) Any of the directors of the bank; d) Any of the bank's key management personnel; e) A close relation of any of the bank's directors or key management personnel; f) A shareholder owning a material interest in the bank; g) A concern in which any of the bank's directors or a close relation of any of the bank's directors or any of its material shareholders has a substantial interest.		Not Complied		We observed that there is no any established process to identify the related party.
3(7)(ii)	Checked that there is a process to identify and report the following types of transactions been identified as transactions with related parties that is covered by this direction. a) The grant of any type of accommodation, as defined in the monetary board's Directions on maximum amount of accommodation. b) The creation of any liabilities of the bank in the form of deposits, borrowings and investments. c) The provision of any services of a financial or non-financial nature provided to the bank or received from the bank. d) The creation or maintenance of reporting lines and information flows between the bank and any related parties which may lead to the sharing of potentially proprietary, confidential or otherwise sensitive information that may give benefits to such related parties.		Not Complied		There is no any process to identify the related party transaction.

CORPORATE GOVERNANCE CONTD...

Sec.	Procedure Performed	Complied	Not Complied	N/A	Reference
3(7) (iii)	Checked whether the board has a process to ensure that the bank does not engage in transactions with related parties as defined in direction 3(7)(i) above, in a manner that would grant such parties "more favorable treatment" than that accorded to other constituents of the bank carrying on the same business. a) Granting of "total net accommodation" to related parties, exceeding a prudent percentage of the bank's regulatory capital, as determined by the board. For purposes of this sub-direction: I) "Accommodation" shall mean accommodation as defined in the Banking Act Directions, No.7 of 2007 on Maximum Amount of Accommodation. II) The "total net accommodation" shall be computed by deducting from the total accommodation, the cash collateral and investments made by such related parties in the bank's share capital and debt instruments with a maturity of 5 years or more. b) Charging of a lower rate of interest than the bank's best lending rate or paying more than the bank's deposit rate for a comparable transaction with an unrelated comparable counterparty. c) Providing of preferential treatment, such as favorable terms, covering trade losses and/or waiving fees/commissions, that extend beyond the terms granted in the normal course of business undertaken with unrelated parties; d) Providing services to or receiving services from a related-party without an evaluation procedure; e) Maintaining reporting lines and information flows that may lead to sharing potentially proprietary, confidential or otherwise sensitive information with related parties, except as required for the performance of legitimate duties and functions.		Not Complied		There's no proper procedure in this regard.

CORPORATE GOVERNANCE CONTD...

Sec.	Procedure Performed	Complied	Not Complied	N/A	Reference
3(7) (iv)	Checked that the bank has a process for granting accommodation to any of its directors and key management personnel, and that such accommodation is sanctioned at a meeting of its board of directors, with not less than two thirds of the number of directors other than the director concerned, voting in favour of such accommodation and that this accommodation be secured by such security as may from time to time be determined by the Monetary board as well.			N/A	No such incident was reported.
3(7) (v)	a) Checked that the bank has a process, where any accommodation has been granted by a bank to a person or a close relation of a person or to any concern in which the person has a substantial interest, and such person is subsequently appointed as a director of the bank, that steps have been taken by the bank to obtain the necessary security as may be approved for that purpose by the Monetary board, within one year from the date of appointment of the person as a director.			N/A	No such incident was observed
	b) Checked where such security is not provided by the period as provided in Direction 3(7)(v)(a) above, has the bank taken steps to recover any amount due on account of any accommodation, together with interest, if any, within the period specified at the time of the grant of accommodation or at the expiry of a period of eighteen months from the date of appointment of such director, whichever is earlier.			N/A	No such incident was observed.
	c) Checked that there is a process to identify any director who fails to comply with the above sub-directions be deemed to have vacated the office of director and has the bank disclose such fact to the public.			N/A	No such incident was observed.
	d) Checked the process in place to ensure clause 3 (7) (v) (c) does not apply to any director who at the time of the grant of the accommodation was an employee of the bank and the accommodation was granted under a scheme applicable to all employees of such bank.			N/A	No such incident was observed.

CORPORATE GOVERNANCE CONTD...

Sec.	Procedure Performed	Complied	Not Complied	N/A	Reference
3(7)(vi)	Checked that there is a process in place to identify when the bank grants any accommodation or "more favorable treatment" relating to the waiver of fees and/or commissions to any employee or a close relation of such employee or to any concern in which the employee or close relation has a substantial interest other than on the basis of a scheme applicable to the employees of such bank or when secured by security as may be approved by the Monetary board in respect of accommodation granted as per Direction 3(7)(v) above.	Complied			Bank is applying the credit manual for this process.
3(7)(vii)	Checked that there is a process to obtain prior approval from the Monitory board for any accommodation granted by a bank under Direction 3(7) (v) and 3(7)(vi) above, nor any part of such accommodation, nor any interest due thereon been remitted without the prior approval of the Monetary board and any remission without such approval is void and has no effect.		Not Complied		There is no proper procedure in this regard.
3(8) 3(8)(i)	Disclosures Checked that the board has disclosed:				
	a) Annual audited financial statements prepared and published in accordance with the formats prescribed by the supervisory and regulatory authorities and applicable accounting standards, and that such statements published in the newspapers in an abridged form, in Sinhala, Tamil and English.	Complied			Observed the annual report 2011, Further, those statements were published in the following newspapers. 1. The Island 2. Divaina 3. Thinakural
	b) Quarterly financial statements are prepared and published in the newspapers in an abridged form, in Sinhala, Tamil and English.	Complied			Observed that the quarterly financial statements are also published as above as per the requirements of CBSL.

CORPORATE GOVERNANCE CONTD...

Sec.	Procedure Performed	Complied	Not Complied	N/A	Reference
3(8)(ii)	Checked that the board has made the following minimum disclosures in the annual report:				
	a) The statement to the effect that the annual audited financial statements have been prepared in line with applicable accounting standards and regulatory requirements, inclusive of specific disclosures.	Complied			These have been checked with reference to the annual report of year 2011.
	b) The report by the board on the bank's internal control mechanism that confirms that the financial reporting system has been designed to provide reasonable assurance regarding the reliability of financial reporting, and that the preparation of financial statements for external purposes has been done in accordance with relevant accounting principles and regulatory requirements.	Complied			These have been checked with reference to the annual report of the year 2011.
	c) Checked that the board has obtained the external auditor's report on the effectiveness of the internal control mechanism referred to in Direction 3(8)(ii)(b) above.	Complied			These have been checked with reference to the annual report of year 2011.
	d) Details of directors, including names, qualifications, age, experience fulfilling the requirements of the guideline fitness and propriety, transactions with the bank and the total of fees/remuneration paid by the bank.	Complied			These have been checked with reference to the annual report of year 2011.
	e) Total net accommodation as defined in 3(7)(iii) granted to each category of related parties. The net accommodation granted to each category of related parties shall also be disclosed as a percentage of the bank's regulatory capital.			N/A	These have been checked with reference to the annual report of year 2011.
	f) The aggregate values of remuneration paid by the bank to its key management personnel and the aggregate values of the transactions of the bank with its key management personnel, set out by broad categories such as remuneration paid, accommodation granted and deposits or investments made in the bank.			N/A	No accommodation provided to related parties as per the explanation of the board secretary. This has been checked with reference to the annual report of year 2011.
	g) Checked that the board has obtained the external auditor's report on the compliance with Corporate Governance Directions.	Complied			
	h) A report setting out details of the compliance with prudential requirements, regulations, laws and internal controls and measures taken to rectify any material non-compliance.	Complied			These have been checked with reference to annual report of year 2011.

CORPORATE GOVERNANCE CONTD...

Sec.	Procedure Performed	Complied	Not Complied	N/A	Reference
	i) A statement of the regulatory and supervisory concerns on lapses in the bank's risk management, or non-compliance with these Directions that have been pointed out by the Director of Bank Supervision, if so directed by the Monetary board to be disclosed to the public, together with the measures taken by the bank to address such concerns.	Complied			According to the page No. 62 of the annual report 2011, the details of the compliance with regulations and requirements of law etc have been disclosed.
3.9	Transitional and Other General Provision.				
3 (9) (i)	Compliance with this direction shall commence from 1st January 2008 onwards and all licensed commercial banks shall – comply with this provision of direction by or before 1st January 2009 except where extended compliance dates have been specifically provided for in this direction.	Complied			The bank is applying the directions stated in SMIB Act & CBSL directions in this regard.
3 (9) (ii)	In respect of the bank that have been incorporated by specific statutes in Sri Lanka, the Board as specified in such statutes shall continue to function in term of provisions of the respective statutes, provided they takes steps to comply with all provision of this Directions that are not inconsistent with the provision of the respective statutes.	Complied			The bank is applying the directions stated in SMIB Act & CBSL directions in this regard.
3 (9) (iii)	The direction shall apply to the branches of the foreign bank operating in Sri Lanka to the extent that it is not inconsistent with the regulation and laws applicable in such bank's country. The branch of foreign shall also publish its parent bank's annual corporate governance report together with its Annual report and accounts of the branch operation in Sri Lanka.			N/A	The bank is applying the directions stated in SMIB Act & CBSL directions in this regard.
3 (9) (iv)	In the event of a conflict between any of the provision of this direction and the Articles of Association (or Internal Rules) pertaining to any bank, the provision of this direction shall prevail. However if the Articles of Association of an individual bank set a more stringent that that specified in this directions, such provision in the Articles of Association may be followed.			N/A	The bank is applying the directions stated in SMIB Act & CBSL directions in this regard.
3 (9) (v)	If any person shall as ill health or any incapacity as provided in the Banking Act, the Monetary Board considers that exemption referred to in Direction 3 (2) (ii) B, 3 (3) (ii) A should not be availed of, such ground may be notified to the person by the Monetary Board, and after hearing, the Monetary Board may limit the period of exemption.			N/A	

DIRECTOR'S STATEMENT ON BANK'S INTERNAL CONTROL

In line with the Banking Act Directions No 12 of 2007 section 3 (8)11(b), and the guidelines issued by the Institute of Chartered Accountants of Sri Lanka ICASL, the Board of Directors (The Board) present this report on Internal control system, of State Mortgage & Investment Bank.

The Board is responsible for internal control of the Bank and for reviewing its effectiveness.

The Board of Directors ("Board") has determined that internal control system has been designed to provide reasonable assurance that; the assets are properly safeguarded, Maintaining of proper books of accounts and reliability of financial reporting system of the bank. However the system does not provide absolute assurance for elimination of possible errors, irregularities and frauds due to inherent risk.

The Board established the system to provide effective internal control system within the bank, said control procedure include followings;

- The Board has established different sub committees to ensure the adequacy and integrity of the internal control system within the bank and delegated the authority of the board among the layers of corporate management, senior management and managers of the bank in order to assist the board in implementation of; policies, procedures for assessing and management of risk faced by the bank.

- Board Integrated Risk Management Committee consists of independent non executive directors. The committee is responsible to review the risk profile of the bank, identifies the principal risk faced by the bank and prepares the policies based on the risk management of the bank.

- The Internal Audit Division of the Bank performs the tests on sample basis to ensure whether the financial and operational activities of the bank are in agreement with the laid down internal control procedures. Audits are carried out on all units and branches frequently of which is determined based on level of risk associate with the functional units and the products of the bank. Head of internal audit is responsible to submit independent objective report to Chairman of the Board of Directors in respect of the audit observations on irregularities, misstatements, frauds in financial and operational affairs of the bank.

- In general, the Board Audit Committee reviews the overall effectiveness of the internal control system in place and report to the Board of directors regularly in respect of the specific observations on internal control weaknesses. In this respect, mechanism used by the committee includes; review of the Auditor General's report, Internal Audit reports, regulatory reports, annual/ monthly financial statements and progress reports.

- The Board has reviewed whether the financial reporting processes of the bank ensure that the annual financial statements are prepared in accordance with the Sri Lanka Accounting Standards and the guidance on reporting requirements issued by the Central Bank of Sri Lanka.

- Even though a structured annual review of design and effectiveness of bank's internal control over financial reporting has not been carried out, the Board has already determined that the documentation of the internal control system of the bank which would facilitate review of the effectiveness of the internal controls is of paramount important.

- The Board has realized that there are additional control procedures to be designed and implemented over the financial reporting process in order to ensure more effective internal control system of the bank. Following steps that have been identified during last year for further strengthening the processes are still in progress.

  I. Completion of documentation of significant processes related to financial reporting and further strengthening the documentation standards to comply with the best practices.

  II. Performing much more structured control testing to ensure that the implementation of particular controls were in effect throughout the year and significant deficiencies have been discussed and addresses at the

DIRECTOR'S STATEMENT ON BANK'S INTERNAL CONTROL CONTD...

Board. If there are weaknesses/additional risks identified by the Internal Auditors/ Audit Committee these have to be properly addressed by providing additional control with adequate follow - up procedures.

Subject to the above areas identified for further strengthening of the processes, to the best of our knowledge the Board confirms that the system of internal control is sound and has been designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of Financial Statements for external purpose has been done in accordance with applicable Accounting Standards and regulatory requirements.

The external auditors have reviewed the above Directors Statement on Internal Control included in the annual report of the Bank for the year ended 31 December 2012 and reported to the Board that nothing has come to their attention that causes them to believe that the statement is inconsistent with their understanding of the process adopted by the Board in the review of the design and effectiveness of the internal control system of the Bank. Further the external auditors have given an emphasis of matter paragraph highlighting the procedures followed by the Board and the risk management aspect of the bank.

....
Chairman of the Audit Committee

....
Director

....
Director

AUDITOR GENERAL'S REPORT ON BANK'S INTERNAL CONTROL

විගණකාධිපති දෙපාර්තමේන්තුව
கணக்காய்வாளர் தலைமை அதிபதி திணைக்களம்
AUDITOR GENERAL'S DEPARTMENT

මගේ අංකය எனது இல My No.	FB/E/SMIB/FA/2012	ඔබේ අංකය உமது இல Your No.		දිනය திகதி Date	25th September 2013

Assurance Report of the Auditor General to the Board of Directors on the Director's Statement on Internal Control of State Mortgage and Investment Bank

Introduction

This report is to provide assurance on the Directors' Statement on Internal Control ("Statement") of State Mortgage and Investment Bank included in the annual report for the year ended 31 December 2012. In carrying out this assurance engagement I was assisted by a firm of Chartered Accountants in public practice.

Management's responsibility

Management is responsible for the preparation and presentation of the Statement in accordance with the "Guidance for Directors of Banks on the Directors' Statement on Internal Control" issued in compliance with section 3(8)(ii)(b) of the Banking Act Direction No. 12 of 2007, by the Institute of Chartered Accountants of Sri Lanka.

My responsibility and compliance with SLSAE 3050

My responsibility is to issue a report to the Board of Directors on the Statement based on the work performed. I conducted my engagement in accordance with Sri Lanka Standard on Assurance Engagement SLSAE 3050 – Assurance Report for Banks on Directors' Statement on Internal Control issued by the Institute of Chartered Accountants of Sri Lanka.

Summary of work performed

This engagement has been conducted to assess whether the Statement is both supported by the documentation prepared by or for Directors and appropriately reflects the process the Directors have adopted in reviewing the system of internal control for the Bank.

The procedures performed are limited primarily to inquiries of bank personnel and existence of documentation on sample basis that supports the process adopted by the Board of Directors.

SLSAE 3050 does not require me to consider whether the Statement covers all risks and controls, or to form an opinion on the effectiveness of the Bank's risk and control procedures. SLSAE 3050 also does not require me to consider whether the processes described to deal with material internal control aspects of any significant problems disclosed in the annual report will, in fact, remedy the problems.

My Conclusion

Based on the procedures performed, nothing has come to my attention that causes me to believe that the statement included in the annual report is inconsistent with our understanding of the process the Board of Directors have adopted in the review of the design and effectiveness of internal control over financial reporting of the Bank.

Without qualifying my opinion, I draw your attention to the Director's Statement on internal control, over financial reporting where the Board of Directors has followed limited procedures in reviewing the design and effectiveness of internal controls over financial reporting and steps have been taken to strengthen the processes.

H.A.S Samareweera
Auditor General

අංක 306/72 පොල්දුව පාර, බත්තරමුල්ල , ශ්‍රී ලංකාව
இல. 306/72, பொல்துவ வீதி, பத்தரமுல்லை இலங்கை
No.306/72, Polduwa Road, Battaramulla , Sri Lanka

දුරකථනය / தொலைபேசி / Telephone. 2887028 /034
ෆැක්ස් අංකය / பக்ஸ் இல / Fax No. 2887223
ඉලෙක්ට්‍රොනික් තැපැල් / ஈ- மெயில் / E-mail. oaggov@sltnet.lk

ANNEXURE 1

1. Reviewed the documentation prepared by or for the directors to support their statement intended to be made.

2. Reviewed the minutes of the meetings of the Board of Directors and of relevant Board Committees.

3. Considered whether the Director's statement on Internal Control covers the year under review and that adequate processes are in place to identify any significant matters arising.

4. Obtained written representations from directors on matters material to the statement on internal control when other sufficient appropriate audit evidence cannot reasonably be expected to exist.

SUSTAINABILITY REPORT

Continuing a legacy of over 80 years is no small feat, and moreover a great responsibility. Thus, we take our mission to heart, and perform at our best by creating a more robust business model which stands out in terms of sustainability and social responsibility. It is these qualities that have bought us forward thus far, and we believe that they are more important than ever for our future.

CORPORATE SOCIAL RESPONSIBILITY

An organization has three main responsibilities to consider if it is to march forward. It has to be responsible for its own progress, the progress of its staff and the progress of the social and physical environment in which it operates.

In relation to the latter, we are proud to say that the Corporate Social Responsibility practices of the State Mortgage & Investment Bank is 'par excellence'

We are well aware that no one segment of society can march ahead whilst ignoring the other segments. That is why the CSR practices of the SMIB lays special emphasis on catering to the needs of all segments of society.

Sri Lanka, as a nation, is just recovering from 3 decades of war that has left many people, irrespective of race or religion, with deep physical and psychological wounds. Our CSR practices reach out to help all such affected people. This is our responsibility, as a leading state bank. Indeed, we are proud of what we are doing for the betterment of society and the environment!

Extending hands for humanity

A concession given to a customer's family at their difficult time

Blood Donation Campaign at Head Office

FINANCIAL
INFORMATION

At SMIB, transparency remains one of our strongest brand pillars. Our dedication to performance has bonded well for us this year, as our customer base and asset base has shown significant growth in 2012, amidst many industry pitfalls. The faith placed in us by our customers has always been our guiding light, and we renew our pledge to deliver our very best to all of Sri Lanka.

DIRECTORS' REPORT

Directors' Report

The Board of Directors of the State Mortgage & Investment Bank has pleasure in presenting their report together with the Annual Accounts for the Year ended 31st December 2012.

Directors

In accordance with the provisions of the SMIB Law No.13 of 1975 as amended, the Board consists of nine fit and proper persons appointed by the Minister of Finance and Planning. Three members represent the Ministry of Agriculture, Ministry of Housing and Ministry of Livestock and Rural Community Development. The said Directors of the Bank including the Chairman possess wide knowledge and experience in Social Science, Legal, Finance and Commerce. Three members constitute a Quorum. A meeting of the Board shall be held at least once a month or more if the chairman decides necessary. 12 meetings were held in the year 2012.

Directors' Interests in Contracts and Proposed Contacts

No Director was directly or indirectly interested in any contract with Bank for the Year ended 31st December 2012. Directors have disclosed their other directorships and connections at Board meetings so as to ensure that they refrain from voting on matters in which they have an interest. A review of the operation of the Bank during the financial year and results of those operations are contained in the General Manager's Review and Financial Highlights of this Report.

Principal Activities

Promoting Housing, Agricultural and Industrial Development Finance and Savings Mobilizations are the main activities of the Bank.

Expanded its network and introduced more efficient customer service strategy. It also simultaneously introduced a new recovery culture.

Review of Operations

A review of the Bank of the Bank during the financial year and results of those operations are contained in the General Manager's Review and Financial Highlights of this Report.

Name of Director	No of meetings attended
Dr.Jagath Wellawatte	12
Mr.Dhammika Weerasekara	12
Mr.Shamraz Yehiya	08
Mr. V.S.Bandara	12
Mr.V.Mohamed Ameen	12
Mrs.K.D.L. Kadanarachchi	02
Mr.S.M.G. Jayaratne	05
Mr.Sarath Hysinth	10
Mr.Bandusiri	05
Mr Perera	01

Future Development

The Bank formulated a new Strategic Plan for 2013 to 2017 to achieve the set goals and objectives. The Bank will also look for new I business opportunities to enter into Housing , A Agricultural and Industrial sectors.

Audit Committee

All the Members of the committee are Non Executive Directors and their reports is contained on Page 65 of this Report.

Profit and Appropriations

The Total Income of the Bank for 2012 was Rs. 3011Mn. An analysis of the Net Income is given on page 91.

Name of Director	2012 (Rs.000)	2011 (Rs.000)
Gross Income	3,010,507	2,687,223
Interest Income	2,931,312	2,611,206
Interest Expenses	1,725,197	1,213,932
Net Interest Income	1,206,115	1,397,273
Other Income	79,196	76,019
Net Income	1,285,427	1,473,293
Less: Operating Expenses	762,988	621,665
Value Added Tax	92,174	146,557
Operating Profit before Tax	430,264	688,578
Less: Provision for Taxation	157,802	178,309
Profit for the Year	272,462	510,269
Retained Profits brought Forward	1,743,969	1,579,827
Profit Available for Appropriation	2,016,431	2,090,096
Appropriation	-	-
Deemed Dividend Tax	79,262	176,560
Payments to Consolidated Fund	25,000	-
Transfers to Reserve Fund	9,791	27,749
Transfers to Investment Fund	83,962	141,818
Balance Carried Forward	1,818,416	1,743,969

Deemed Dividend & Reserves

Deemed dividend tax for the year 2012 has been provided at 25 % on the net profit for the year after taxation in accordance with the provisions for the Inland Revenue Act No38 of 2000.

Reserves

Total reserves as at 31st December2012 amounted to Rs2,919.93 mn (2011- Rs2753.41 million) movement of which are given on page 74 in the statement of Changes in Equity.

DIRECTORS' REPORT CONTD...

Corporate Donations

During the year no donations were granted.

Capital Expenditure

The details of Property, Plant, and Equipment and Motor Vehicles of the Bank are shown in Notes on page 98.

Market value of immovable proprieties

SMIB does not own tangible immovable proprieties as at 2012

Contributed Capital

Sri Lankan Government has contributed the capital amounting to Rs. 889.81 Mn.

Substantial Shareholding and Share Information

Government of Sri Lanka is the sole contributor of capital in SMIB. Additional information is provided in Note 22 to the Financial Statements.

Payment to Consolidated Fund

The payments made to the Consolidated Fund for the period of year 2000 to 2012 totaled upto Rs.25 million.

Statutory Payments

The Directors, to the best of their knowledge and belief are satisfied that all statutory payments in relation to the Government and employees have been made upto date.

Taxation

Income Tax for 2012 has been provided at 28% on taxable income arising from the operations of the Bank.

Compliance with Applicable Laws and Regulations

To the best of our knowledge there have been no violation of possible violation of laws or regulations by the Bank or any jurisdiction whose effect should be disclosed. There have been no irregularities Involving management or employees that could have material financial effect or otherwise.

Customers and Borrowers

One of the SMIB'S prime objectives is to provide Housing Loans to the nation at an affordable rate). The Bank has taken special effort to carry out regular surveys in this regard.

Depositors and Suppliers

Depositors are the main fund providers to the Bank. Deposit rates are published and are competitive. Principal and Capital on due dates are paid promptly. It is the Bank's policy to call for quotations for the supply of goods and services and ensure prompt payment.

Environmental Protection

All business activities of SMIB affects the environment in one way or other. It is the policy of SMIB to keep adverse effects by the environment to a minimum and to promote co-operation and compliance with the relevant authorities and regulations.

There have been no material events occurring after the Balance Sheet date that require adjustments to or disclosure in the Financial Statements.

Going Concern

After reviewing the Financial Statements and considering sovereign Stakeholders involvement, forecasts and budgets: borrowing requirements and maturities, liabilities existing and contingent. Financial adaptability to changing circumstance product and market trends, overall risk management strategies and strengths, weaknesses, opportunities and threats, the Board is satisfied that the Bank has adequate resources to continue its operations in the foreseeable future without materially curtailing its operations. Therefore, we continued to adopt the going concern basis in preparing the financial Statements.

Equitable Treatment to all Stakeholders

While valuing the patronage of all our Stakeholders, the Bank has made all endeavors to ensure equitable treatment to all our Stakeholders.

The Auditors

The Audit Account of the State Mortgage & Investment Bank for the year ended 31st December 2012 was carried out under the Auditor General's directions in pursuance of provisions in Article 154(1) of the Constitution of the Democratic Socialist Republic of Sri Lanka read in conjunction with Section 13 (1) of the Finance Act No.38 of 1971.

By order of the Board

Secretary to the Board

BOARD INTEGRATED RISK MANAGEMENT COMMITTEE REPORT

Composition of the Board Integrated Risk Management Committee

The Board appointed Integrated Risk Management Committee (BIRMC) as at the end of the year comprised of following members.

Mr. V.M Ameen-Chairman-Non Executive Director
Mr. Shamraz Yehiya- Non Executive Director
Mr. W.M.D.S Hysinth- Non Executive Director
Mr. W.M.Dayasinghe-CEO
Mrs. W.Geeganage-DGM-Compliance
Mrs. P.A.C.K Amarasinghe-AGM-Legal
Mr. T.M.J.Wickramasekara-AGM-Recovery
Mrs. J.I.Senanayake-AGM-Risk Management (Secretary of the BIRMC)

All the members were appointed by the Board of Directors at the meeting held on 27.03.2012.The committee consist of three non executive directors and five members from the senior management.

Brief profiles of each member are given on pages 10 and 11.

Charter of the BIRMC

The BIRMC was established by the Board of Directors ,in compliance with the section 3(6) (v) of the Direction no.12 of 2007,on 'Corporate Governance for Licensed Specialized Banks in Sri Lanka' issued by the Monitory board of Central Bank of Sri Lanka.

The Charter of the BIRMC was reviewed and approved by the Board which was held on 27.03.2012.Approved charter stipulates its authority, structure and responsibilities.

As per the charter, key responsibilities of the BIRMC are as follows.

- Assist the Board of Directors in understanding the risk management function adopted by the bank in operating the banking business and the adequacy of the same.
- Review bank's risk appetite.
- Review and approve bank's key risk policies on the establishment of risk limits and receive reports on bank's adherence to significant limits.
- Receive reports from, review with, and provide feedback to, management on the categories of risk the bank faces, including credit, market, liquidity and operational risk, the exposures in each category, significant concentrations within those risk categories, the metrics used to monitor the exposures and management's views on the acceptable and appropriate levels of those risk exposures.
- Review bank's credit, market, liquidity and operational risk management frameworks, including significant policies, processes and systems that management uses to manage risk exposures, as well as risk measurement methodologies and approaches to stress testing.
- Review the independence and authority of the risk management function.
- Review bank's Risk Capital Framework (credit, market, liquidity and operational risks), including significant inputs and assumptions.

BIRMC meetings

BIRMC meets on quarterly basis. During the year, form the establishments of the risk management division, the bank convened three BIRMC meetings. The attendance of members is given below.

Name of Director	No of meetings attended
Mr.Shamraz Yehiya	03
Mr.V.Mohamed Ameen	03
Mr.Sarath Hysinth	03

During the year, BIRMC worked very closely with the senior management personnel handling business operations and managing risks, in fulfilling the responsibilities assigned to the committee.

Reporting

Processes proposed and discussed at the BIRMC meetings are reported to the Board for the approval, with the recommendation of the BIRMC. Recommendations made by the BIRMC during the year under review were approved by the Board without any material change. Minutes of the BIRMC is reported to the board with required elaborations for the information of the board.

V.M.Ameen
Chairman-Board Integrated Risk Management Committee

30th March 2013

BOARD AUDIT COMMITTEE REPORT

Objective of the Board Audit Committee (BAC) is to ensure the transparency of the corporate governance practices in the Bank. Board approved charter of the BAC are clearly defined the responsibility and functions of the committee and also comply with the guidance given in Central bank directions No.12 of 2007.

Composition of the committee

	Member	Status of BAC	Committee member		Attendance of meeting during the year 2012
			since	to	
1	Mr.V.M.Ameen	Chairman	2010 January	23.04.2013	04
2	Mr.V.S.Bandara	Member	2010 January	To date	04
3	Mrs.K.D.C.Kadanachchi (Relinquish the membership upon transfer to foreign ministry)	Member	2011 April	2012 February	01
4	Mr.W.W.D.Sarath Hysinth	Member	2012 December	To date	01
5	Mr.S.L.G.Bandusiri	Member	2012 December	To date	01
6	Mr.Shamraz Yahiya	Alternative Member	2012 December	To date	01

All members of the committee are independent non executive directors and they are literate financial management and each having experiences in Legal, Accounting, Auditing and Finance fields.

Role & responsibility of the committee

Purpose of the BAC is to assist the Board of directors to carry out the financial and operational affairs of the bank. A scope of the BAC includes,

- Maintain and review the accounting and operational control system of the bank.
- Examine the compliance of financial statements with LKAS and other applicable rules and regulations.
- Review and monitor the scope and integrity of the risk based internal audit program annually.
- Liaison with external auditors in respect of their audit scope and reports
- Monitor and review the corrective actions for the internal audit reports.
- Review matters pertaining to staff disciplines, elimination of irregularities and corrupt practices with the objective to take actions by the management.
- With the assistance of internal audit committee review the adequacy and effectiveness of internal control system in financial reporting and operational activities of the bank.
- Review and maintain the reliability and effectiveness of the management information system and IT governance of the Bank.
- Committee ensures that, the Board is aware of all matters which are significantly impact on financial status and affairs of the business.
- Review the adequacy of internal arrangements and control system to avoid/ minimize risks face by the bank.

Meetings

During the financial year ended December 2012, four meetings were held. Brief overview of the matters taken up at the meetings are listed below,

Budget performance

Committee reviewed the progress of achievement in budgetary targets on fund mobilization and credit related activities.

Financial Reporting

On behalf of the Board of directors, the committee has reviewed preparation and presentation of quarterly/annual financial statements as per new LKAS and other regulatory requirements and submitted report to BOD.

BOARD AUDIT COMMITTEE REPORT CONTD...

Regulatory Compliance

Quarterly review has been performed by the committee to ensure that financial and operational activities of the bank are conducted inline with all regulatory requirements.

Internal Audit Function

In response to the recommendation made by the committee, the board of directors has approved the Internal Audit Manual prepared by the Internal Audit Division.

Reviewed and recommended the risk based internal audit program for implementation of the year 2013.

The committee has monitored and reviewed the management responses for the internal audit reports on financial and operational activities of the bank. Committee also reviewed the effectiveness of the performance of internal audit division and monitors the adequacy of the internal audit assignments were carried out inline with the approved audit program.

External Audit Reports

The committee has reviewed the external audit concerns disclosed in the final audit reports and reviewed the adequacy of the corrective actions taken by the management to address the concerns of the external auditors.

System of Internal Controls

On behalf of the Board of directors, committee has reviewed effectiveness of the IT and internal control system relating to the financial and operational activities of the bank in line with the internal control system defined in the manual of internal control system.

V.M. Ameen,
Chairman of the Committee.

STATEMENT OF THE DIRECTORS' RESPONSIBILITIES

The responsibility of the Directors in relation to the Financial Statements of the Bank, prepared in accordance with the provision of the Banking Act No.30 of 1988 and as amended by Act No.46 is set out in the following statements.

As per the provisions of the sections 7 & 8 of State Mortgage and Investment Bank Act No.13 of 1975 as amended the general supervision control and administration of the affairs and the business of the Bank is entrusted to the Board of Directors headed by the Chairman , and the Board may exercise all such powers and do all such acts and things as may be necessary for carrying out the business of the Bank.

The responsibility of the Directors are to safeguard the interest and sustain the transparency of the Bank and ensure the interest of the Bank's Depositors, Creditors, Shareholders and other Stakeholders.

The Directors of the State owned Bank should be also aware of the duties, obligation, liabilities and disadvantages caused due to lapses and negligence as they are accountable to the public of the country.

As per the provisions of the Banking Act No.30 of 1988, the Directors are required to prepare Financial Statements for each financial year and place them before a general meeting.

The Financial statements of the Bank gives a true and fair view of;

1. The state of affairs of the Bank as at 31st December2012.
2. The profit or loss of the Bank for the financial year then ended.

The Directors are required to ensure that the following requirements are taken into account while preparing these Financial Statements;

1. The appropriate accounting policies have been selected and applied in a consistent manner and material departures, if any have been disclosed and explained
2. Judgments and estimates have been made in a reasonable and prudent manner.
3. All applicable Accounting Standards, as relevant, have been complied with and
4. The Internal Control over Financial Reporting is effective

The Financial Statements for the year 2012 prepared and presented in the report are in conformity with the requirements of Sri Lanka Accounting Standards, Banking Act No.30 of 1988 and amendments thereto.

The Audit Committee of the Bank reviews the quarterly accounts and recommends them to the Board prior to release of these Financial Statements.

The Directors have taken reasonable steps to safeguard the assets of the Bank while taking steps to prevent and detect frauds if any and any other irregularities. For this purpose the Directors have instituted an effective and comprehensive system of Internal Control comprising Internal Audit, Internal Checks, Financial and other controls in order to carry out the operations in an orderly manner, safeguard the assets and secure as far as possible the accuracy and reliability of the records.

The Directors confirm that to the best of their knowledge, all taxes, duties and levies payable by the Bank, all contributions, levies and taxes on behalf of and in respect of its Staff Members , and all other known statutory dues as were due and payable by the Bank at Balance Sheet date have been paid or where relevant, provided for.

The Bank will have adequate resources to continue in operational existence as a going concern in the foreseeable future.
The Directors are of the view that they have discharged their responsibilities as set out in the above statement.

By order of the Board,

Secretary to the Board
Colombo, Sri Lanka

AUDITOR GENERAL'S REPORT

විගණකාධිපති දෙපාර්තමේන්තුව
கணக்காய்வாளர் தலைமை அதிபதி திணைக்களம்
AUDITOR GENERAL'S DEPARTMENT

මගේ අංකය / எனது இல / My No. FB/E/SMIB/FA/2012

ඔබේ අංකය / உமது இல / Your No.

දිනය / திகதி / Date 06th September 2013

The Chairman,
State Mortgage and Investment Bank

Report of the Auditor General on the Financial Statements of the State Mortgage and Investment Bank for the year ended 31 December 2012 in terms of Section 14(2)(c) of the Finance Act, No.38 of 1971.

The audit of financial statements of the State Mortgage and Investment Bank ("Bank") for the year ended 31 December 2012 comprising the Statement of Financial Position as at 31 December 2012 and the Income Statement, Statement of Comprehensive income , statement of changes in equity and cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory information, was carried out under my direction in pursuance of provisions in Article 154(1) of the Constitution of the Democratic Socialist Republic of Sri Lanka read in conjunction with Section 13(1) of the Finance Act, No.38 of 1971. My comments and observations which I consider should be published with the Annual Report of the Bank in terms of Section 14 (2) (c) of the Finance Act appear in this report. . A detailed report in terms of Section 13(7)(a) of the Finance Act was furnished to the Chairman of the Bank on 12 June 2013.

1.2 Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Sri Lanka Accounting Standards and for such internal control as the management determines is necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error.

1.3 Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Bank's preparation and fair presentation of the financial

අංක 306/72 පොල්දුව පාර, බත්තරමුල්ල , ශ්‍රී ලංකාව
இல. 306/72, பொல்துவ வீதி, புத்தரமுல்லை இலங்கை
No.306/72, Polduwa Road, Battaramulla , Sri Lanka

දුරකථනය / தொலைபேசி / Telephone. 2887028 /034
ෆැක්ස් අංකය / பக்ஸ் இல / Fax No. 2887223
ඉලෙක්ට්‍රොනික් තැපැල් / ஈ- மெயில் / E-mail. oaggov@sltnet.lk

AUDITOR GENERAL'S REPORT CONTD...

statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. Sub-sections (3) and (4) of Section 13 of the Finance Act, No.38 of 1971 give discretionary powers to the Auditor General to determine the scope and extent of the audit.

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

1.4 Basis for Qualified Opinion

My opinion is qualified based on the matters described in paragraph 2.2 of this report.

2 Financial Statements

2.1 Qualified Opinion

In my opinion, except for the effects of the matters described in paragraph 2.2 of this report, the financial statements give a true and fair view of the financial position of the State Mortgage and Investment Bank as at 31 December 2012 and its financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards

2.2 Comments on Financial Statements

2.2.1 Accounting Standards

The following observation is made.

The contribution by the employer had not been invested in order to discharge the obligation under a defined benefit plan, in terms of LKAS 19.

2.2.2 Accounting Deficiencies

Following accounting deficiencies were observed in audit.

(a). Although Financial Statements had been prepared in terms of Sri Lanka Accounting Standards (SLFRS and LKAS) general ledger accounts had not been updated to reflect the balances shown in the financial statements.

(b) Error correction of With Holding Tax deducted from three investments in 2011, amounting to Rs: 3,512,268 had been debited to interest income accounts of commercial papers in 2012 instead of being charged against retained earnings.

(c) A sum of Rs. 1,150,000 payable to Sri Lanka Broadcasting Corporation on 8 invoices remained without being settled from the year 2009. However it had not been shown as a liability in the statement of financial position for the year under review.

(d) Three invoices of Sri Lanka Broadcasting Corporation amounting to Rs. 309,000 had been settled twice thus making an overpayment of Rs. 309,000.

2.2.3 Reconciliation of Accounts

Following observations are made.

(a) Balances amounting to Rs. 8,561,853 and Rs. 4,874,419 shown under the current assets and current liabilities respectively had remained without being reconciled with computerized system since the year 2004.

(b) An unreconciled debit balance amounting to Rs.50,000 had remained since 2006 in the People's Bank Account No 309-1-001-2-2536402 without being identified.

2.2.4.Unexplained Differences

(a) The following unexplained differences were observed in audit.

Branch	Account	Balance according to Cash Flow Statement Rs.	Balance according to Financial Statements Rs.	Difference Rs.
Chilaw	Cash in hand	634,843	1,254,074	619,230
Kandy	Cash in hand	2,177,333	2,792,595	615,261

(b) Differences of Rs. 66,345,852 had been observed between the ledger balances aggregating to Rs. 10,802,272,919 and balances generated by the computerized system aggregating to Rs. 10,868,618,771 in fifteen branches with regard to fixed deposits and saving deposits as at 31 December 2012.

AUDITOR GENERAL'S REPORT CONTD...

2.2.5 Accounts Receivable and Payable

The following observations are made.

(a) Out of the total balances of accounts receivable aggregating Rs. 3,358,335,358 shown in the statement of financial position as at 31 December 2012, a sum of Rs. 330,753,858 or 9.85 per cent had not been confirmed by the respective customers up to 31 March 2013.

(b) Out of the total balances of accounts payable aggregating Rs. 5,842,122,106 shown in statement of financial position as at 31 December 2012, a sum of Rs. 1,236,914,346 or 21.17 per cent had not been confirmed by the parties concerned up to 31 March 2013.

(c) Accrued interest amounting to Rs.134,321,918 payable to the General treasury, remained without being settled for a long period.

(d) Advances aggregating Rs. 1,298,657 paid to various institutions of the Bank from the year 2011,had not been settled even as at 08 May 2013.

2.2.6 Lack of Documentary Evidence for Audit

The following item of accounts could not be satisfactorily vouched in audit due to non availability of evidence indicated against such item.

Item	Value Rs	Evidence not available
"Saga " Musical Show at Royal college	100,000	Receipts
Payment for Musical Show for Welfare Society	500,000	Bills
Sponsorships and expenses made at new year festival in Kuwait	566,700	Detailed sponsorship bills and vouchers

2.2.7 Non-compliance with Laws, Rules, Regulations, and Management Decisions

The following instances of non-compliance were observed in audit.

Reference to Laws, Rules, Regulations etc.	Non-compliance
(a) Section 133 of the Inland Revenue Act, No.10 of 2006	Instances were observed non obtaining of income declarations and non payment of Withholding Tax on due dates.
(b)Financial Transactions Reporting Act, No,6 of 2006	Instances were observed where the signature of the depositor and Branch Officer had not been placed on the "Know Your Customer"
(c)Treasury Circular No: IAI/2002/02 of 28 November 2002	A Register for computers, computer accessories and software had not been maintained.
(d) Financial Regulation 395(c)	Bank Reconciliation Statements relating to Head Office had not been prepared on due dates.
(e) Section 2.1 of Chapter XV of the Establishments Code	Rs.513,500 had been spent for the foreign travelling by using the business class. According to the Establishment Code, air travel in a economy class only is allowed.

2.2.8 Unauthorized Transactions

Following observations are made.

a) Loans on fixed deposits aggregating Rs. 867,242 had been granted in 4 instances by the Galle branch without obtaining the approvals of the authorized officer.

b) Fixed Deposits loans aggregating Rs.1,039,145 had been given to a customer without obtaining the signature of the customer in the Register of the Fixed Deposit Loans .

c) Approval had been granted by the Board to reimburse the Chairman's Credit Card bills to the extent of Rs.250,000. However it was observed that bills aggregating to Rs.727,962 had been reimbursed during the year under review. It was further observed that the vouchers were not supported by bills or invoices.. Hence the purpose of reimbursing the amounts in the Credit Card bills is questionable.

(d) Pay as you earn tax on salaries of employees amounting to Rs.8,649,997 had been paid by the Bank on behalf of the employees without obtaining proper approvals from the General Treasury.

2.2.9 Unidentified Transactions

Deposits aggregating Rs.1,584,145 as at the end of the year under review had been shown as unidentified deposits.

2.2.10Frauds

Following observations are made.

a) A balance of Rs. 2,400,000 had been shown in Fraud Account under other debtors in the financial statements for the year under review. This represented loans given in the years 1996 and 1998 amounting to Rs.800,000 and Rs.1,600,000 respectively relating to which Court cases are pending.

b) Payments aggregating Rs.945,000 had been made for 9 invoices and Rs. 315,000 for 3 invoices of the Sri Lanka Broadcasting Corporation in the year 2008. The General Manager of the Bank had given written instructions for the payment of a sum of Rs. 402,500 on 7 invoices only to the Sri Lanka Broadcasting Corporation. Cheques were drawn in favor of SLBC and the person who had collected the cheques from the Bank had deposited its to an account opened in the name of SLBC which was not an official account of the Corporation. Therefore the liability of the payment for invoices of the Sri Lanka Broadcasting Corporation still remained outstanding.

H.A.S. Samaraweera
Auditor General

STATEMENT OF FINANCIAL POSITION

As at 31st December	Note	2012 Rs.	2011 Rs.	2010 Rs.
Assets				
Cash and Cash Equivalents	9	30,932,075	32,760,719	39,271,350
Placements with Banks	10	3,249,719,268	3,859,378,141	2,847,295,553
Loans and Receivables to Customers	11	18,315,422,376	16,170,476,100	14,430,361,399
Financial Investments – Available-for-Sale	12	19,644,078	21,324,078	24,699,078
Financial Investments – Held-to-Maturity	13	296,742,675	92,359,085	341,202,248
Property, Plant and Equipment	14	50,755,258	57,989,091	39,122,827
Deferred Tax Assets	15	50,419,175	51,891,266	53,729,963
Other Assets	16	345,199,151	223,113,817	205,090,878
Total assets		**22,358,834,058**	**20,509,292,298**	**17,980,773,295**
Liabilities				
Due to Banks	17	23,630,116	386,205,707	21,105,870
Due to Customers	18	17,236,563,604	15,088,049,691	13,196,931,272
Other Borrowings	19	733,889,904	668,229,672	697,848,914
Employee Benefit Liability	20	191,126,904	192,952,327	201,393,195
Other Liabilities	21	363,881,240	530,632,628	550,605,755
Total Liabilities		**18,549,091,767**	**16,866,070,025**	**14,667,885,005**
Equity				
Stated Capital/Assigned Capital	22	889,812,899	889,812,899	889,812,899
Statutory Reserve Fund	23	172,981,335	163,190,403	135,441,590
Retained Earnings	24	1,818,415,609	1,743,968,971	1,579,826,801
Other Reserves	25	928,532,447	846,250,000	707,807,000
Total Equity		**3,809,742,291**	**3,643,222,273**	**3,312,888,290**
Total Equity and Liabilities		**22,358,834,058**	**20,509,292,298**	**17,980,773,295**
Contingent Liabilities and Commitments	26	-	-	-

Certification:

We,the undersigned being the Chairman, Acting General Manager and Assistant General Manager(Finance) of State Mortgage and Investment Bank certify jointly that,

(a) The above statements have been prepared in compliance with the format and definitions prescribed by the Central Bank of Sri Lanka.

(b) The information contained in these statements have been extracted from the audited Financial Statements of the Bank. The Board of Directors are responible for the preparation and presentation of these Financial Statements.These Financial Statements were approved by the Board of Directors and signed on their behalf.

Jagath Wellawatte Chairman	**W. J.K. Geeganage** Acting General Manager	**E.M.R.Lalith Munaweera** Assistant General Manager (Finance)

INCOME STATEMENT

For the year ended 31st December	Note	2012 Rs.	2011 Rs.
Interest Income		2,931,312,254	2,611,205,626
Interest Expenses		(1,725,196,745)	(1,213,932,409)
Net Interest Income	1	**1,206,115,509**	**1,397,273,217**
Fee and Commission Income		72,580,010	64,510,890
Fee and Commission Expenses		-	-
Net Fee and Commission Income	2	**72,580,010**	**64,510,890**
Other Operating Income (net)	3	6,615,513	11,508,471
Total Operating Income		**1,285,311,032**	**1,473,292,578**
Impairment for Loans and Other Losses	4	116,716	(16,492,209)
Net Operating Income		**1,285,427,748**	**1,456,800,369**
Personnel Expenses	5	(515,731,406)	(388,026,224)
Other Expenses	6	(247,257,319)	(233,639,563)
Operating Profit/(Loss) Before Value added Tax (VAT)		**522,439,023**	**835,134,582**
Value added Tax (VAT) on Financial Services		(92,174,295)	(146,556,814)
Profit/(Loss) Before Tax		**430,264,728**	**688,577,768**
Tax Expenses	7	(157,802,290)	(178,308,921)
Profit/(Loss) for the Year		**272,462,439**	**510,268,848**

STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31st December 2012	Note	2012 Rs.	2011 Rs.
Profit/(Loss) for the year		272,462,439	510,268,848
Other Comprehensive Income, net of tax			
Gains and Losses on re-measuring Available-for-sale Financial Assets		(1,680,000)	(3,375,000)
Total Comprehensive Income for the year		**270,782,439**	**506,893,848**

STATEMENT OF CHANGES IN EQUITY

For the year ended 31st December 2012	Contributed Capital Rs.	Statutary Reserve Rs.	Capital Reserve Rs.	General Reserve Rs.	Title Indemnity Fund Rs.	Investment Fund Rs.	Retained Earnings Rs.	AFS Reserve Rs.	Total Rs.
Balance as at 31.12.2010	889,812,899	135,441,590	9,176,000	683,280,000	1,031,000	-	1,579,826,800	14,320,000	3,312,888,289
Net profit for the year							510,268,984		510,268,984
Deemed Dividend Tax							(176,560,000)		(176,560,000)
Other Comprehensive Income								(3,375,000)	(3,375,000)
Transfer during the year		27,748,813					(27,748,813)		-
Transfer to Investment Fund						141,818,000	(141,818,000)		-
Balance as at 31.12.2011	**889,812,899**	**163,190,403**	**9,176,000**	**683,280,000**	**1,031,000**	**141,818,000**	**1,743,968,971**	**10,945,000**	**3,643,222,273**
Net profit for the year							272,462,440		272,462,440
Deemed Dividend Tax							(79,262,420)		(79,262,420)
Other Comprehensive Income								(1,680,000)	(1,680,000)
Transfer during the year		9,790,932					(9,790,932)		-
Transfer to Investment Fund						83,962,447	(83,962,447)		-
Transfer to Consolidated Fund							(25,000,000)		(25,000,000)
Balance as at 31.12.2012	**889,812,899**	**172,981,335**	**9,176,000**	**683,280,000**	**1,031,000**	**225,780,447**	**1,818,415,611**	**9,265,000**	**3,809,742,292**

STATEMENT OF CASH FLOW

For the year ended 31st December	Note	2012 Rs.	2011 Rs.
Cash Flows from Operating Activities			
Interest Received		2,393,616,140	2,313,826,339
Interest Payments		(1,725,196,745)	(1,213,932,409)
Cash Payments to Employees and Suppliers		(428,322,435)	(383,654,000)
Receipts from Other Operating Activities		76,975,251	74,092,861
Payments on Other Operating Activities		(228,403,448)	(220,941,575)
Operating Profit before Changes in Operating Assets		**88,668,763**	**569,391,216**
(Increase)/Decrease in Operating Assets:			
Funds Advanced to Customers		**(2,189,754,654)**	**(1,772,178,155)**
Other Short-term Securities		745,356,070	(1,001,865,819)
		(1,444,398,584)	(2,774,043,974)
Increase /(Decrease) in Operating Liabilities:			
Deposits from Customers		1,805,460,389	1,884,464,319
Others		16,735,755	45,457,839
		1,822,196,144	**1,929,922,158**
Net Cash from Operating Activities before Income Tax		**466,466,322**	**(274,730,600)**
Income Tax & Deemed Divident Tax Paid		(429,038,000)	(581,747,000)
Net Cash from Operating Activities		**37,428,322**	**(856,477,600)**
Cash Flows from Investing Activities			
Dividends Received		2,370,750	1,926,500
Purchase of Property & Equipment		248,000	-
Proceeds from Sales of Property & Equipment		(9,212,000)	(31,564,000)
Interest Received from Deposits with Other Banks		442,846,343	269,184,403
Interest Received from Government Securities		30,051,668	27,125,709
Net Cash from Investing Activities		**466,304,761**	**266,672,612**
Cash Flows from Financing Activities			
Repayment of Debentures		-	-
Repayment of Loans		(16,334,822)	(29,619,000)
Proceeds from Borrowings		81,995,053	-
Payment to the Consolidated Fund		(25,000,000)	-
Net Cash from Financing Activities		**40,660,231**	**(29,619,000)**
Net Increase in Cash and Cash Equivalents		544,393,314	(619,423,988)
Cash and Cash Equivalents at the Beginning of the Year		(261,827,988)	357,596,000
Cash and Cash Equivalents at End of the Year		**282,565,326**	**(261,827,988)**
Reconciliation of Cash and Cash Equivalents			
Cash and Short Term Funds		30,932,075	32,760,719
Government of Sri Lanka Treasury Bills		275,263,367	91,617,000
Borrowings from Banks		(23,630,116)	(386,205,707)
		282,565,326	**(261,827,988)**

ACCOUNTING POLICIES

1. Corporate Information

1.1 General
State Mortgage & Investment Bank was incorporated as the Ceylon State Mortgage Bank on 6th December 1931. The Bank was established by the State Mortgage & Investment Bank Law No 13 of 1975, amalgamating the Ceylon State Mortgage and Agriculture and Industrial and Credit Corporation established in 1943.

1.2 Principal Activities and Nature of Operations

The State Mortgage & Investment Bank is predominantly engaged in providing housing finance while recently diversified into other credit facilities such as vehicle loans and personal loans in order to face the rising competition.

1.3 Directors' Responsibility Statement

The Board of Directors takes the responsibility for the preparation and presentation of these Financial Statements as per the provisions of the Companies Act No.07 of 2007 and the Sri Lanka Accounting Standards (SLFRS).

1.5 Date of Authorization

The Financial Statements of State Mortgage & Investment Bank for the year ended 31 December 2012 were authorized for issue in accordance with a resolution of the Board of Directors on 28.02.2013.

The staff strength of the Bank as at December 31, 2012 was 323 (302 as at December 31, 2011).

2. Summary of Significant Accounting Policies

2.1. Basis of Preparation

For all periods up to and including year ended 31 December 2011, the Bank prepared its Financial Statements in accordance with Sri Lanka Accounting Standards applicable as at 31 December 2011 ("SLAS"). These Financial Statements for the year ended 31 December 2012 are the first the Bank has prepared in accordance with Sri Lanka Financial Reporting Standards. These SLFRSs are effective from January 1, 2012 and comparatives (year 2011and 2010) also re-measured. Hence the date of transition to SLFRS is January 1, 2011.

The Financial Statements of the State Mortgage and Investments Bank (SMIB) is prepared in Sri Lanka Rupees on a historical cost basis except for available for sale investment which has been measured at fair value. No adjustments have been made for inflationary factors.

2.1.1. Statement of compliance

The Financial Statements of the Bank is prepared in accordance with Sri Lanka Accounting Standards (LKASs and SLFRSs) as issued by the Institute of Chartered Accountants of Sri Lanka.

2.1.2. Presentation of Financial Statements

The Bank presents its statement of financial position broadly in order of liquidity. Contractual maturities of assets and liabilities of the bank is presented in note 30.

Financial assets and financial liabilities are offset and the net amount reported in the statement of financial position only when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the assets and settle the liability simultaneously. Income and expenses are not offset in the income statement unless required or permitted by any accounting standard or interpretation, and as specifically disclosed in the accounting policies of the Bank.

2.2. Significant accounting Judgments, Estimates and Assumptions

In the process of applying the Bank's accounting policies, management has exercised judgement and estimates in determining the amounts recognised in the financial statements. The key significant accounting judgements, estimates and assumptions involving uncertainty are discussed below, whereas the respective carrying amounts of such assets and liabilities are given in related Notes.

2.2.1. Judgements

Taxation
The Bank is subject to income tax and other taxes including VAT on financial services. Significant judgment was required to determine the total provision for current, deferred and other taxes pending the issue of tax guidelines on the treatment of the adoption of SLFRS in the Financial Statements and the taxable profit for the purpose of imposition of taxes. Uncertainties exist, with respect to the interpretation of the applicability of tax laws, at the time of the preparation of these financial statements.

The Bank recognized assets and liabilities for current, deferred and other taxes based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the income and deferred tax amounts in the period in which the determination is made.

2.2.2. Estimates and Assumptions

Going concern
The Bank's management has made an assessment of its ability to continue as a going concern and is satisfied that it has the resources to continue in business for the foreseeable future. Furthermore, management is not aware of any material uncertainties that may cast significant doubt upon the Bank's ability to continue as a going concern. Therefore, the financial statements continue to be prepared on the going concern basis.

ACCOUNTING POLICIES CONTD...

Fair Value of Financial Instruments

Where the fair values of financial assets and financial liabilities recorded on the statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The inputs to these models are derived from observable market data where possible, but if this is not available, judgement is required to establish fair values.

Impairment Losses on Loans and Advances

Individually assessed Loans and Advances

For financial assets carried at amortised cost (such as loans and advances to customers as well as held to maturity investments), the Bank first assesses individually whether objective evidence of impairment exists for financial assets that are individually significant, or collectively for financial assets that are not individually significant.

Impairment of Available For Sale Investments

The Bank reviews its investments classified as Available For Sale investments at each reporting date to assess whether they are impaired. This requires similar judgement as applied to the individual assessment of loans and advances.

The Bank also records impairment charges on available for sale equity investments when there has been a significant or prolonged decline in the fair value below their cost. The determination of what is 'significant' or 'prolonged' requires judgement. In making this judgement, the Bank evaluates, among other factors, historical share price movements and duration and extent to which the fair value of an investment is less than its cost.

Deferred Tax Assets

Deferred tax assets are recognised in respect of tax losses to the extent that it is probable that future taxable profit will be available against which the losses can be utilised. Judgement is required to determine the amount of deferred tax assets that can be recognised, based upon the likely timing and level of future taxable profits, together with future tax-planning strategies.

Employee Benefit Liability- Gratuity

The cost of the defined benefit plan - gratuity, is determined using an actuarial valuation. Actuarial valuation involves making assumptions about inter-alia discount rates, future salary increases, remaining working life of employees and mortality rates. Due to the long term nature of these obligations, such estimates are subject to significant uncertainty. The assumptions used are as follows.

	2012	2011
Rate of Interest	13.00%	11.00%
Rate of Salary Increase	8.50%	8.50%
Retirement Age	55-60 years	55-60 years

The employment benefit obligation of gratuity provision is given in Note 20.

Employee Benefit Liability - Medical Benefit

The cost of the defined benefit plan - medical benefit is determined using an actuarial valuation. Actuarial valuation involves making assumptions about inter-alia discount rates, medical inflation and mortality rates. Due to the long term nature of these obligations, such estimates are subject to significant uncertainty.

The assumptions used are are as follows.

	2012	2011
Discount Rate	13.00%	11.00%
Medical Inflation	10.00%	10.00%
Participant Data (Actives) census information at	31.12.2012	31.12.2011

Description of employee benefits is given in Note 20.

2.3. Summary of Significant Accounting Policies

2.3.1. Financial Instruments - Initial Recognition and Subsequent Measurement

a. Date of Recognition

Regular way purchases of financial assets are recognised using settlement date accounting. The settlement date is the date that an asset is delivered to an entity. Settlement date accounting refers to the recognition of an asset on the day it is received by the entity. When settlement date accounting is applied an entity accounts for any change in the fair value of the assets to be received during the period between the trade date and settlement date in the way as it accounts for the acquired asset.

Non-regular way purchases of financial assets and liabilities are recognised on the trade date, i.e., the date that the bank becomes a party to the contractual provisions of the instrument.

A regular way purchase is a purchase of a financial asset under a contract whose terms require delivery of the assets within the time frame established generally by a regulation or convention in the market place concerned.

b. Initial Measurement of Financial Instruments

The classification of financial instruments at initial recognition depends on their purpose and characteristics

ACCOUNTING POLICIES CONTD...

and the management's intention in acquiring them. All financial instruments are measured initially at their fair value plus significant transaction costs, except in the case of financial assets and financial liabilities recorded at fair value through profit or loss.

c. Available for Sale Financial Instruments

Available For Sale investments include investment in unit trust. Investments classified as available for sale are those which are neither classified as held for trading nor designated at fair value through profit or loss.

The Bank has not designated any loans or receivables as available for sale. After initial measurement, available for sale financial investments are subsequently measured at fair value.

Unrealised gains and losses are recognised directly in equity (Other comprehensive income) in the 'Available for Sale Reserve'. When the investment is disposed of, the cumulative gain or loss previously recognised in equity is recognised in the income statement in 'Other operating income'. Dividends earned whilst holding available for sale financial investments are recognised in the income statement as 'Other operating income' when the right of the payment has been established. The losses arising from impairment of such investments are recognised in the income statement in 'Impairment losses on financial investments' and removed from the 'Available for Sale Reserve'.

d. Held to Maturity Financial Investments

Held to maturity financial investments are non-derivative financial assets with fixed or determinable payments and fixed maturities, which the Bank has the intention and ability to hold to maturity. After initial measurement, held to maturity financial investments are subsequently measured at amortised cost using the EIR, less impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the EIR. The amortisation is included in 'Interest and similar income' in the income statement. The losses arising from impairment of such investments are recognised in the income statement line 'Impairment expense'.

If the Bank were to sell or reclassify more than an insignificant amount of held to maturity investments before maturity (other than in certain specific circumstances), the entire category would be tainted and would have to be reclassified as available for sale. Furthermore, the Bank would be prohibited from classifying any financial asset as held to maturity during the following two years.

e. Other Financial Liabilities

Financial instruments issued by the Bank that are not designated at fair value through profit or loss, are classified as other financial liabilities, where the substance of the contractual arrangement results in the Bank having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset.

Other financial liabilities include, deposits from customers, amount due from banks, borrowings from bank and others and debentures. After initial measurement, other financial liabilities are subsequently measured at amortised cost using the EIR. Amortised cost is calculated by taking into account any discount or premium on the issue and costs that are an integral part of the EIR.

f. Financial Assets classified as Loans and Receivables

Financial Assets classified as Loans and Receivables include non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than:

- Those that the bank intends to sell immediately or in the near term and those that the bank, upon initial recognition, designates as at fair value through profit or loss
- Those that the bank, upon initial recognition, designates as available for sale
- Those for which the bank may not recover substantially all of its initial investment, other than because of credit deterioration

After initial measurement, amounts 'Due from banks' and 'Loans and advances to customers' are subsequently measured at amortised cost using the EIR, less allowance for impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees and costs that are an integral part of the EIR. The amortisation is included in 'Interest and similar income' in the income statement. The losses arising from impairment are recognised in the income statement in 'Impairment expense'.

g. Day 1' Difference for Staff loan

All staff loans granted at below market interest rate are recognised at fair value. The difference between the fair value and the amount disbursed are treated as day 1 difference and amortised as staff cost over the loan period by using effective rate. The staff loans are subsequently measured at amortised cost.

h. Reclassification of Financial Assets

Reclassifications are recorded at fair value at the date of reclassification, which becomes the new amortised cost.

For a financial asset reclassified out of the 'Available For Sale' category, any previous gain or loss on that asset that has been recognised in equity is amortised to profit

ACCOUNTING POLICIES CONTD...

or loss over the remaining life of the investment using the EIR. Any difference between the new amortised cost and the expected cash flows is also amortised over the remaining life of the asset using the EIR. If the asset is subsequently determined to be impaired, then the amount recorded in equity is recycled to the income statement.

The Bank may reclassify a non-derivative trading asset out of the 'held for trading' category and into the 'loans and receivables' category if it meets the definition of loans and receivables and the Bank has the intention and ability to hold the financial asset for the foreseeable future or until maturity. If a financial asset is reclassified, and if the Bank subsequently increases its estimates of future cash receipts as a result of increased recoverability of those cash receipts, the effect of that increase is recognised as an adjustment to the EIR from the date of the change in estimate.

Reclassification is at the election of management, and is determined on an instrument by instrument basis. The Bank does not reclassify any financial instrument into the fair value through profit or loss category after initial recognition. An analysis of reclassified financial assets is disclosed in Note 08.

2.3.2. De-Recognition of Financial Assets and Financial Liabilities

a) Financial assets

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognised when:

- The rights to receive cash flows from the asset have expired
- The Bank has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass-through' arrangement
- The Bank has transferred substantially all the risks and rewards of the asset
- The Bank has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset

When the Bank has transferred its rights to receive cash flows from an asset or has entered into a pass-through arrangement, and has neither transferred nor retained substantially all of the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Bank's continuing involvement in the asset. In that case, the Bank also recognises an associated liability. The transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the Bank has retained.

Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Bank could be required to repay.

b) Financial Liabilities

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability. The difference between the carrying value of the original financial liability and the consideration paid is recognised in profit or loss.

2.3.3. Repurchase and Reverse Repurchase Agreements

Securities sold under agreements to repurchase at a specified future date are not derecognised from the statement of financial position as the Bank retains substantially all of the risks and rewards of ownership. The corresponding cash received is recognised in the statement of financial position as an asset with a corresponding obligation to return it, including accrued interest as a liability within 'Due to banks', reflecting the transaction's economic substance as a loan to the Bank. The difference between the sale and repurchase prices is treated as interest expense and is accrued over the life of agreement using the EIR.

Conversely, securities purchased under agreements to resell at a specified future date are not recognised in the statement of financial position. The consideration paid, including accrued interest, is recorded in the statement of financial position, within 'Placements with banks', reflecting the transaction's economic substance as a loan by the Bank. The difference between the purchase and resale prices is recorded in 'Net interest income' and is accrued over the life of the agreement using the EIR.

2.3.4. Determination of Fair Value

The fair value for financial instruments traded in active markets at the reporting date is based on their quoted market price without any deduction for transaction costs.

For all other financial instruments not traded in an active market, the fair value is determined by using appropriate valuation techniques. Valuation techniques include the discounted cash flow method, comparison with similar instruments for which market observable prices exist, and other relevant valuation models.

Certain financial instruments are recorded at fair value using valuation techniques in which current market transactions or observable market data are not available.

ACCOUNTING POLICIES CONTD...

Their fair value is determined using a valuation model that has been tested against prices or inputs to actual market transactions and using the Bank's best estimate of the most appropriate model assumptions.

An analysis of fair values of financial instruments and further details as to how they are measured are provided in Note 28.

2.3.5. Impairment of Financial Assets

a) Loans and Advances

The Bank assesses at each reporting date, whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset (an 'incurred loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated.

Evidence of impairment may include: indications that the borrower or a group of borrowers is experiencing significant financial difficulty; the probability that they will enter bankruptcy or other financial reorganisation; default or delinquency in interest or principal payments; and where observable data indicates that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

The criteria used to determine that there is such objective evidence includes:

- Known cash flow difficulties experienced by the borrower
- Past due contractual payments of either principal or interest
- Breach of loan covenants or conditions
- The probability that the borrower will enter bankruptcy or other financial realisation

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the assets's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement.

The impairment allowances on individually significant accounts are reviewed more regularly when circumstances require. This normally encompasses re-assessment of the enforceability of any collateral held and the timing and amount of actual and anticipated receipts. Individually assessed impairment allowances are only released when there is reasonable and objective evidence of a reduction in the established loss estimate.

Collectively assessed loans and advances

Impairment is assessed on a collective basis in two circumstances:

- To cover losses which have been incurred but have not yet been identified on loans subject to individual assessment; and
- For homogeneous groups of loans that is not considered individually significant.

Incurred but not yet identified impairment

Individually assessed loans for which no evidence of loss has been specifically identified on an individual basis are grouped together according to their credit risk characteristics for the purpose of calculating an estimated collective loss. This reflects impairment losses that the Bank has incurred as a result of events occurring before the balance sheet date, which the Bank is not able to identify on an individual loan basis, and that can be reliably estimated. These losses will only be individually identified in the future. As soon as information becomes available which identifies losses on individual loans within the group, those loans are removed from the group and assessed on an individual basis for impairment.

The collective impairment allowance is determined after taking into account:

- Historical loss experience in portfolios of similar credit risk; and
- Management's experienced judgment as to whether current economic and credit conditions are such that the actual level of inherent losses at the balance sheet date is likely to be greater or less than that suggested by historical experience.

Homogeneous groups of loans and advances

Statistical methods are used to determine impairment losses on a collective basis for homogeneous groups of loans. Losses in these groups of loans are recorded on an individual basis when individual loans are written off, at which point they are removed from the group.

The following method is used to calculate historical loss experience on a collective basis:

When the group of loan by nature is long term, the Bank uses Probability of Default method (Risk Migration)

Under this methodology the movement in number of customers in to bad categories over the periods are used to estimate the amount of loans that will eventually be written off as a result of the events occurring before the balance sheet date which the Bank is not able to identify

ACCOUNTING POLICIES CONTD...

on an individual loan basis, and that can be reliably estimated.

Under this methodology, loans are grouped into ranges according to the number of days in arrears and statistical analysis is used to estimate the likelihood that loans in each range will progress through the various stages of delinquency, and ultimately prove irrecoverable.

Current economic conditions and portfolio risk factors are also evaluated when calculating the appropriate level of allowance required covering inherent loss.

These additional macro and portfolio risk factors may include:

- Recent loan portfolio growth and product mix,
- Unemployment rates, gross domestic production (GDP) growth, inflation
- Interest rates
- Changes in government laws and regulations

The impairment loss on loans and advances is disclosed in more detail in Note 11.

b) Financial Assets Carried at Amortised Cost

For financial assets carried at amortised cost (such as amounts due from banks and loans and advances to customers), the Bank first assesses individually whether objective evidence of impairment exists for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement. Interest income continues to be accrued on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

The interest income is recorded as part of 'Interest and similar income'. Loans together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realised or has been transferred to the Bank. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced by adjusting the allowance account. If a future write-off is later recovered, the recovery is credited to the 'Impairment expense'.

The present value of the estimated future cash flows is discounted at the financial asset's original EIR. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current EIR. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of credit risk characteristics such as asset type, collateral type, past-due status and other relevant factors.

Future cash flows on a group of financial assets that are collectively evaluated for impairment are estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently.

Estimates of changes in future cash flows reflect, and are directionally consistent with, changes in related observable data from year to year (such as changes in unemployment rates, property prices, commodity prices, payment status, or other factors that are indicative of incurred losses in the group and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

c) Available for Sale Financial Investments

For available for sale financial investments, the Bank assesses at each reporting date whether there is objective evidence that an investment is impaired.

In the case of equity investments classified as available for sale, objective evidence would also include a 'significant' or 'prolonged' decline in the fair value of the investment below its cost. The Bank treats 'significant' generally as 20% and 'prolonged' generally as greater than six months. Where there is evidence of impairment,

ACCOUNTING POLICIES CONTD...

the cumulative loss measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that investment previously recognised in the income statement - is removed from equity and recognised in the income statement. Impairment losses on equity investments are not reversed through the income statement; increases in the fair value after impairment are recognised in other comprehensive income.

d) Renegotiated Loans

Where possible, the Bank seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated, any impairment is measured using the original EIR as calculated before the modification of terms and the loan is no longer considered past due. Management continually reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original EIR.

e) Collateral Valuation

The Bank seeks to use collateral, where possible, to mitigate its risks on financial assets. The collateral comes in various forms such as cash, securities, letters of credit/ guarantees, real estate, receivables, inventories, other non-financial assets and other credit enhancements

2.3.6. Offsetting Financial Instruments

Financial assets and financial liabilities are offset and the net amount reported in the Statement of Financial Position if, and only if, there is a currently enforceable legal right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously. This is not generally the case with master netting agreements, therefore, the related assets and liabilities are presented gross in the Statement of financial position.

2.3.7. Leasing

The determination of whether an arrangement is a lease, or it contains a lease, is based on the substance of the arrangement and requires an assessment of whether the fulfilment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset.

2.3.8. Recognition of income 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. The following specific recognition criteria must also be met before revenue is recognised.

a) Interest and Similar Income and Expense

For all financial instruments measured at amortised cost, interest bearing financial assets classified as available for sale and financial instruments designated at fair value through profit or loss, interest income or expense is recorded using the EIR. EIR is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The calculation takes into account all contractual terms of the financial instrument (for example, prepayment options) and includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the EIR, but not future credit losses.

Once the recorded value of a financial asset or a group of similar financial assets has been reduced due to an impairment loss, interest income continues to be recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

b) Fee and Commission Income

The Bank earns fee and commission income from a diverse range of services it provides to its customers. Fee income can be divided into the following two categories:

Fee Income Earned from Services that are Provided over a Certain Period of Time

Fees earned for the provision of services over a period of time are accrued over that period. These fees include commission income and asset management, custody and other management and advisory fees. Credit related fees are deferred and recognised as an adjustment to the EIR of the loan.

Fee Income from Providing Transaction Services

Fees arising from negotiating or participating in the negotiation of a transaction for a third party, such as the arrangement of the acquisition of shares or other securities or the purchase or sale of businesses, are recognised on completion of the underlying transaction. Fees or components of fees that are linked to a certain performance are recognised after fulfilling the corresponding criteria.

c) Dividend Income

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

d) Net Trading Income

Results arising from trading activities include all gains and losses from changes in fair value and related interest income or expense and dividends for financial assets and financial liabilities 'held for trading'. This includes any ineffectiveness recorded in hedging transactions.

ACCOUNTING POLICIES CONTD...

e) Other Income

Other income is recognized on a cash basis.

f) Other Expenses

All other expenses have been recognized in the Financial Statements as they are incurred in the period to which they relate. All expenditure incurred in the operation of the business and in maintaining the capital assets in a state of efficiency has been charged to revenue in arriving at the Bank's profit for the year.

2.3.9. Cash and Cash Equivalents

Cash and short term funds include cash in hand, balances with banks, placements with banks and money at call and at short notice. Details of the cash and short term funds are given in Note 9 to the Financial Statements.

2.3.10. Property, Plant and Equipment

Property, plant and equipment is stated at cost or valuation excluding the costs of day-to-day servicing, less accumulated depreciation and accumulated impairment in value. Changes in the expected useful life are accounted for by changing the depreciation period or method, as appropriate, and treated as changes in accounting estimates.

a) Cost Model

Plant & Equipment are stated at cost, excluding the cost of day-to-day servicing, less accumulated depreciation and accumulated impairment in value. Such cost includes the cost of replacing part of the Plant & Equipment when the cost is incurred, if the recognition criteria are met.

b) Subsequent Cost

The cost of replacing part of an item of Property, Plant & Equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within that part will flow into the Bank and its cost can be reliably measured.

c) Restoration Cost

Expenditure incurred on repairs or maintenance of Property, Plant & Equipment in order to restore or maintain future economic benefits is charged to Statement of Income as incurred.

d) Capital Work-in-Progress

These are expenses of a capital nature directly incurred in the construction of building, major plant and machinery and system development, awaiting capitalisation. These are stated in the Statement of Financial Position at cost.

e) Depreciation

Depreciation is calculated using the straight-line method to write down the cost of property and equipment to their residual values over their estimated useful lives. The estimated useful lives are as follows:

Category of Asset	Period of Depreciation
Motor Vehicles	25.00% p.a.
Furniture and Fittings	12.50% p.a.
Office Equipment	12.50% p.a.
Calculators	25.00% p.a.
Computers	25.00% p.a.
Others	12.50% p.a.

The cost of alterations and modifications made to extension office buildings have been amortised over 4 years or initial lease period, which ever is less. Computer Software is amortised over 4 years.

f) Derecognition

Property, Plant and equipment is derecognised on disposal or when no future economic benefits are expected from its use. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is recognised in 'Other operating income' in the income statement in the year the asset is derecognised.

2.3.11. Intangible Assets

The Bank's other intangible assets include the value of computer software. An intangible asset is recognised only when its cost can be measured reliably and it is probable that the expected future economic benefits that are attributable to it will flow to the Bank.

Intangible assets acquired separately are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses.

The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortised over the useful economic life. The amortisation period and the amortisation method for an intangible asset with a finite useful life are reviewed at least at each financial year-end. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are accounted for by changing the amortisation period or method, as appropriate, and they are treated as changes in accounting estimates. The amortisation expense on intangible assets with finite lives is recognised in the income statement in the expense category consistent with the function of the intangible asset.

Amortisation is calculated using the straight-line method to write down the cost of intangible assets to their residual values over their estimated useful lives as follows:

ACCOUNTING POLICIES CONTD...

The Class of Intangible Assets	Useful Life	Amortisation Method
Computer Software	4 Years	Straight line method

2.3.12. Impairment of Non-Financial Assets

The Bank assesses at each reporting date whether there is an indication that an asset may be impaired. If any indication exists, or when annual impairment testing for an asset is required, the Bank estimates the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or Cash Generating Unit (CGU)'s fair value less costs to sell and its value in use. Where the carrying amount of an asset or CGU exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount.

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. In determining fair value less costs to sell, an appropriate valuation model is used. These calculations are corroborated by valuation multiples, quoted share prices for publicly traded subsidiaries or other available fair value indicators.

2.3.13. Financial Guarantees

In the ordinary course of business, the Bank gives financial guarantees, consisting of letters of credit, guarantees and acceptances. Financial guarantees are initially recognised in the financial statements (within 'Other liabilities') at fair value, being the premium received. Subsequent to initial recognition, the Bank's liability under each guarantee is measured at the higher of the amount initially recognised less cumulative amortisation recognised in the income statement, and the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee.

Any increase in the liability relating to financial guarantees is recorded in the income statement in 'Credit loss expense'. The premium received is recognised in the income statement in 'Net fees and commission income' on a straight line basis over the life of the guarantee.

2.3.14. Retirement Benefit Obligation

a) Gratuity

All the employees of the Bank are eligible for gratuity under the Payment of Gratuity Act No. 12 of 1983.

Employees who have resigned or whose services are terminated other than by retirement are eligible to receive the terminal gratuity under the Payment of Gratuity Act No. 12 of 1983 at the rate of one half of the Gross Salary applicable to the last month of the financial year in which the employment is terminated or resigned, for each year of completed service, for those who have served in excess of 5 years. The Bank measures the present value of the promised retirement benefits of gratuity which is a defined benefit plan using the projected unit credit actuarial valuation method.

The method of calculation of retirement benefit obligation has changed to actuarial valuation method and changes in accounting policy have been retrospectively accounted.

Recognition of Actuarial Losses / Gains
Actuarial losses / gains are recognized in profit or loss.

Expected Return on Assets
Expected return on assets is zero as the plan is not pre funded.

Interest Cost
Interest cost is the expected increase due to interest during the period in the present value of the plan liabilities because the benefits are one year closer to settlement.

Funding Arrangements
The Gratuity liability is not externally funded.

b) Defined contribution plan

The Bank also operates a defined contribution plan. The contribution payable to a defined contribution plan is in proportion to the services rendered to the Bank by the employees and is recorded as an expense under 'Personnel expenses'. Unpaid contributions are recorded as a liability.

The Bank contributes to the following schemes:

Employees' Provident Fund
The Bank and employees contribute 15% and 10% respectively of the employee's monthly gross salary (excluding overtime) to the Provident Fund. The Bank's Provident Fund is an approved fund under the Employees' Provident Fund Act.

Employees' Trust Fund
The Bank contributes 3% of the employee's monthly gross salary excluding overtime to the Employees' Trust Fund maintained by the Employees Trust Fund Board. The employees will be eligible for gratuity under the Payment of Gratuity Act No. 12 of 1983.

c) Medical Benefit

Permananent employees and their families and retirees of State Mortgage & Investment Bank are eligible for medical reimbursement provided that they have adopted to participate in the Scheme and have paid their membership dues. Family members of a retired member is only eligible for benefits under special treatment (either any one of retired member or his/her family member is eligible).

ACCOUNTING POLICIES CONTD...

The method of calculation of retirement benefit obligation has changed to actuarial valuation method and changes in accounting policy have been retrospectively accounted. The Bank uses Projected Unit Credit method for actuarial valuations. Under this method, Actuarial Gains /Losses as they occur, generally reduce /increase the Unfunded Actuarial Accrued Liability. The comparative statements for 2011 have been restated to confirm to changed policies.

Normal and Early Retirement

A participant is eligible for Normal retirement at age 55 provided that he/she has 3 years of service. All participants are eligible for extensions up to the attainment of age 60.

Recognition of Actuarial Losses / Gains

Actuarial losses / gains are recognized in profit or loss.

Expected Return on Assets

Expected return on assets is zero as the plan is not pre funded

Interest Cost

Interest Cost is the time value of Present Value of the Defined Benefit Obligation (PVDBO) and the Current Service Cost (CSC).

Funding Arrangements

The Medical Benefit Scheme is not externally funded

2.3.15. Provisions

Provisions are recognised when the Bank has a present obligation (legal or constructive) as a result of a past event, and 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. The expense relating to any provision is presented in the income statement net of any reimbursement.

2.3.16. Taxes

a) Current Taxation

Current tax assets and liabilities consist of amounts expected to be recovered from or paid to the Commissioner General of Inland Revenue in respect of the current as well as prior years. The tax rates and tax laws used to compute the amount are those that are enacted or subsequently enacted by the Balance Sheet date. Accordingly, provision for taxation is made on the basis of the profit for the year as adjusted for taxation purpose in accordance with the provision of the Inland Revenue Act No. 10 of 2006 and the amendment thereto, at the rates specified in Note 07 to the Financial Statements.

b) Deferred Taxation

Deferred tax is provided using the liability method on temporary differences at the Balance Sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purpose. Deferred tax liabilities are recognised for all temporary differences, except:

- Where the deferred tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and at the time of transaction, affects neither the accounting profit nor taxable profit or loss; and
- In respect of taxable temporary differences associated with investments in Subsidiaries and Associates, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future

Deferred tax assets are recognised for all deductible differences. Carry forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profits will be available against which the deductible temporary differences and the carry forward of unused tax credits and unused tax losses can be utilised, except:

- Where deferred tax assets relating to the deductible temporary differences arise from the initial recognition of an asset or liability in a transaction that is not a business combination and at the time of the transaction, affects neither the accounting profit nor the taxable profit or losses; and
- In respect of deductible temporary differences associated with investments in subsidiaries and associates, deferred tax assets are recognized only to the extent it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which temporary differences can be utilised

The carrying amount of a deferred tax asset is reviewed at each Balance Sheet date and reduced to the extent it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Unrecognised deferred tax asset are reassessed at each Balance Sheet date and are recognise to the extent that is probable that future taxable profit will allow the deferred tax asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rate that are expected to apply in the year when the assets are realised or the liabilities are settled, based on tax rates and tax laws that have been enacted or subsequently enacted at the Balance Sheet date.

ACCOUNTING POLICIES CONTD...

c) Value Added Tax on Financial Services (VAT)

Bank's total value addition was subjected to a 12% Value Added Tax as per section 25A of the Value Added Tax No. 14 of 2002 and amendments thereto.

2.3.17. Events after the Balance Sheet Date

All material events after the Balance Sheet events have been considered where appropriate adjustments or disclosures are made in respective notes to the financial statements.

2.3.18. Related Party Transactions with Government and Government Related Entities

The Bank does not elect the disclosure exemption under para 25 of LKAS 24.

2.3.19. Standards Issued but not yet Effective

The following SLFRS have been issued by the Institute of Chartered Accountants of Sri Lanka that have an effective date in the future. Those SLFRS will have an effect on the accounting policies currently adopted by the Bank and may have an impact on the future financial statements.

(i) SLFRS 9 -Financial Instruments: Classification and Measurement SLFRS 9, as issued reflects the first phase of work on replacement of LKAS 39 and applies to classification and measurement of financial assets and liabilities.

(ii) SLFRS 13 - Fair Value Measurement SLFRS 13 establishes a single source of guidance under SLFRS for all fair value measurements. SLFRS 13 provides guidance on all fair value measurements under SLFRS. SLFRS 9 and SLFRS 13 will be effective for financial periods beginning on or after 01 January 2015 and 2014 respectively.

2.3.20. First Time Adoption of SLFRs and LKAs

The Bank adopted Sri Lanka Accounting Standards comprising LKAS and SLFRS effective from 1 January 2012.Prior to the adoption of SLFRS, the Bank prepared its Financial Statements in accordance with previous Sri Lanka Accounting Standards.

The Bank prepared its opening Financial Statements as at 1 January 2011,the date of transition to SLFRS which forms the starting point of the Bank's financial reporting under SLFRS.The Financial Statements have been prepared in accordance with the Accounting Policies described in Note 2.

In preparing the Financial Statements the Bank has applied the requirements of SLFRS 1 - First Time Adoption of Sri Lanka Accounting Standards, including retrospective application of SLFRS effective for the adoption, unless otherwise indicated. The resulting adjustments are described below.

NOTES TO THE FINANCIAL STATEMENTS

3. First Time Adoption of SLFRS
3.1 Reconciliation of Equity as at 01 January 2011 (Date of transition to SLFRS)

	Note	SLAS* Rs	Reclasification Rs	Remeasurement Rs	SLFRS at 01-01-2011** Rs
Assets					
Cash and cash equivalents		39,271,350	-	-	39,271,350
Placements with banks	a.	2,816,183,164	31,112,389	-	2,847,295,553
Loans and receivables to customers	b.	13,670,350,277	219,954,827	540,056,295	14,430,361,399
Financial investments – Available-for-sale	c.	10,379,078		14,320,000	24,699,078
Financial investments – Held-to-maturity	d.	339,431,145	1,771,103	-	341,202,248
Property, plant and equipment		39,122,827	39,122,827		
Deferred tax assets	e.	-	4,671,586	49,058,377	53,729,963
Interest Receivable	f.	252,838,319	(252,838,319)		-
Other assets		77,373,731	(4,671,586)	132,388,732	205,090,877
Total assets		**17,244,949,891**	**-**	**735,823,404**	**17,980,773,295**
Liabilities					
Due to banks		21,105,870	-	-	21,105,870
Due to customers	g.	12,505,791,631	691,139,640		13,196,931,271
Other borrowings	h.	563,219,804	134,629,110		697,848,914
Employee Benefit Liability	i.		129,037,671	72,355,524	201,393,195
Other liabilities		1,505,412,176	(954,806,421)	-	550,605,755
Total Liabilities		**14,595,529,481**	**-**	**72,355,524**	**14,667,885,005**
Equity					
Stated capital/Assigned capital		889,812,899	-	-	889,812,899
Statutory reserve fund		135,441,590	-	-	135,441,590
Retained Earnings	j.	930,678,921	-	649,147,880	1,579,826,801
Other reserves		693,487,000	-	14,320,000	707,807,000
Total equity		**2,649,420,410**	**-**	**663,467,880**	**3,312,888,290**
Total equity and liabilities		**17,244,949,891**	**-**	**735,823,404**	**17,980,773,295**

*Based on SrI Lanka Accounting Standards(SLAS)at 01st January 2011(Date of Transition)

**Based on SrI Lanka Accounting Standards comprising LKAS and SLFRS at 01st January 2011(Date of Transition)

NOTES TO THE FINANCIAL STATEMENTS CONTD...

3. First Time Adoption of SLFRS
3.2 Reconciliation of equity as at 31 December 2011

	Note	SLAS* Rs	Reclasification Rs	Remeasurement Rs	SLFRS at 31-12-2011** Rs
Assets					
Cash and cash equivalents		32,760,719	-	-	32,760,719
Placements with banks	a.	3,818,048,983	41,329,158	-	3,859,378,141
Loans and receivables to customers	b.	15,469,221,989	224,953,721	476,300,390	16,170,476,100
Financial investments – Available-for-sale	c.	10,379,078	10,945,000	21,324,078	
Financial investments – Held-to-maturity	d.	91,617,000	742,085	92,359,085	
Property, plant and equipment		57,989,091	57,989,091		
Deferred tax assets	e.	-	5,030,159	46,861,107	51,891,266
Interest Receivable	f.	267,024,964	(267,024,964)	-	0
Other assets		80,233,392	(5,030,159)	147,910,584	223,113,817
Total assets		**19,827,275,216**	**-**	**682,017,082**	**20,509,292,298**
Liabilities					
Due to banks		386,205,707			386,205,707
Due to customers	g.	14,390,255,950	697,793,741		15,088,049,691
Other borrowings	h.	533,600,562	134,629,110		668,229,672
Employee Benefit Liability	i.	-	126,320,713	66,631,614	192,952,327
Other liabilities		1,489,376,192	(958,743,564)		530,632,628
Total assets		**16,799,438,411**	**-**	**66,631,614**	**16,866,070,025**
Equity					
Stated capital/Assigned capital		889,812,899		-	889,812,899
Statutory reserve fund		163,190,403		-	163,190,403
Retained Earnings	j.	1,139,528,503		604,440,467	1,743,968,970
Other reserves		835,305,000		10,945,000	846,250,000
Total equity		**3,027,836,805**	**-**	**615,385,467**	**3,643,222,273**
Total equity and liabilities		**19,827,275,216**	**-**	**682,017,081**	**20,509,292,298**

** Based on SrI Lanka Accounting Standards(SLAS)at 31st December 2011*

*** Based on SrI Lanka Accounting Standards comprising LKAS and SLFRS at 31st December 2011*

NOTES TO THE FINANCIAL STATEMENTS CONTD...

3. First Time Adoption of SLFRS
3.3 Reconciliation of Income for the year ended 31 December 2011

	Note	SLAS* Rs	Reclasification Rs	Remeasurement Rs	31st December 2011** Rs
Interest income	b.&d.	2,603,440,234	-	7,765,392	2,611,205,626
Interest expenses	g.&h.	(1,213,932,409)	-	-	(1,213,932,409)
Net interest income		**1,389,507,825**	**-**	**7,765,392**	**1,397,273,217**
Fee and commission income	k.	-	64,510,891	-	64,510,891
Fee and commission expenses		-	-	-	-
Net fee and commission income		**-**	**64,510,891**	**-**	**64,510,891**
Other operating income (net)		76,019,362	(64,510,891)	-	11,508,471
Total operating income		**1,465,527,187**	**-**	**7,765,392**	**1,473,292,579**
Impairment for loans and other losses	b.	-	26,693,557	(43,185,766)	(16,492,209)
Net operating income		**1,465,527,187**	**26,693,557**	**(35,420,374)**	**1,456,800,370**
Personnel expenses	i.	(380,936,456)	-	(7,089,768)	(388,026,224)
Premises,Equipment and Establishment Expenses	l.	(110,636,810)	110,636,810	-	-
Loan losses and Provisions	b.	26,693,557	(26,693,557)	-	-
Other expenses	l.	(123,002,753)	(110,636,810)	-	(233,639,563)
Operating profit/(loss) before value added tax (VAT)		**877,644,725**	**-**	**(42,510,142)**	**835,134,583**
Value added tax (VAT) on financial services		(146,556,814)	-	-	(146,556,814)
Profit/(loss) before tax		**731,087,911**	**-**	**(42,510,142)**	**688,577,769**
Tax expenses	m.	(176,111,651)	-	(2,197,270)	(178,308,921)
Profit/(loss) for the year		**554,976,260**	**-**	**(44,707,412)**	**510,268,848**

** Based on SrI Lanka Accounting Standards(SLAS)at 31st December 2011*

*** Based on SrI Lanka Accounting Standards comprising LKAS and SLFRS at 31st December 2011*

NOTES TO THE FINANCIAL STATEMENTS CONTD...

3.4 Notes to the reconciliation of equity as at 1 January 2011, 31 December 2011 and total comprehensive income for the year ended 31 December 2011

The Bank adopted Sri Lanka Accounting Standards comprising LKAS and SLFRS ("SLFRS") effective 01 January 2012. Prior to the adoption of SLFRS, the Bank repared its Consolidated Financial Statements in accordance with previous Sri Lanka Accounting Standards. The Bank prepared its opening SLFRS Financial Statements as at 01 January 2011, the date of transition to SLFRS which forms the starting point for the Bank financial reporting under SLFRS. These Financial Statements have been prepared in accordance with the accounting policies described in Note 2.

In preparing these Financial Statements, the Bank has applied the requirements of SLFRS1 - First-time adoption of Sri Lanka Accounting Standards, including retrospective application of SLFRS effective for the Bank on adoption, unless otherwise indicated. The resulting adjustments are described below.

a. Placements with banks

The interest receivable on time placements was recognised as part of the Placements with Banks at the year end as part of the amortised cost according to new SLASs requirement. The respective interest receivable balance was previously classified under interest receivable.

b. Loans and receivables to customers

Interest receivable on 'Loans and Receivable' hither to recorded under Interest Receivable is now categorised under 'Loans and Receivable to customers'.

According to SLFRS the the impairment provisioning is calculated collectively as well as individually based on objective evidence.

Based on SLFRS, all loans granted to staff of the Bank at concessionary rates are initially recognised at fair value.Subsequent interest thereon was recognised as per EIR. Day 1 difference is treated as pre-paid staff cost and amortised over the remaining tenor of the loan.The un-amortised staff costs arising from the Staff Loans being deducted from loans and receivables and classified under other assets

c. Financial investments – Available-for-sale

The Bank invests on certain assets with the intention of holding them to maturity. These assets are now categorised under 'Financial Investments Available-for-Sale' and recorded in the Statement of Financial Position at market value when realiable method of estimation of fair value is available. These assets previously carried at cost. The difference between the cost and the fair value is accounted in the Statement of Change in Equity through 'Other Comprehensive Income'

d. Financial investments – Held-to-maturity

Financial Assets where the Bank has the ability and intention to hold to maturity were classified as Held to Maturity and measured at amortized cost using the effective interest rate method.The interest receivable from Held to Maturity investments was previously categorised under interest receivable.

e. Deferred tax assets

The Deffered Tax Asset which was previously categorised under Other Assets is shown separately including the tax effect arising from the actuarial valuation of the Employee Benefit.

f. Interest receivable

Interest receivable from loans and receivables,Financial investments - Held to Maturity and Placements with banks which was previously shown separately has been reclassified under their respective items under SLFRS.

g. Due to Customers

On adoption of SLFRS, the interest expense on amounts due to customers (deposits) is capitalised. This was previously included in 'Other Liabilities'

h. Other Borrowings

On adoption of SLFRS, the interest accrued on borrowed funds is capitalised.This was previously included in 'Other Liabilities'

i. Employee Benefit Liability

The actuarial provision of gratuity and medical benefit previously included in other liabilities has been separately given.

j. Reserves

The net effect of adoption of SLFRS as of the transition date of 01 January 2011 is recorded through "Retained Earnings"

k. Fees and Commission Income

Fees and Commission income which was previously included in 'Other Operating Income' is reclassified.

l. Premises,Equipment and Establishment Expenses

Expenses on equipmemt and establishment are reclassified under 'Other Expenses'.

m. Taxation

This represents the effect on taxes arising on adjustments following the adoption of Sri Lanka Accounting Standards.Pending the issue of tax guidelines, such impact on taxes has been assessed based on the currently applicable tax laws and regulations.

NOTES TO THE FINANCIAL STATEMENTS CONTD...

1. Net Interest Income

	2012 Rs.	2011 Rs.
Interest Income		
Sri Lanka Government Securities	30,051,668	27,125,709
Loans and Advances to Customers	2,276,221,737	2,307,130,122
Financial Investments – Held to Maturity	442,846,343	269,184,403
Other		
Interest in Suspense	95,912,642	(5,048,286)
Staff Loans	86,279,864	12,813,678
Total Interest Income	**2,931,312,254**	**2,611,205,626**
Interest Expenses		
Due to Banks	3,170,909	850,832
Due to Customers	1,710,630,778	1,201,631,887
Other Borrowings	6,520,058	6,574,690
Debt Securities Issued	4,875,000	4,875,000
Total Interest Expenses	**1,725,196,745**	**1,213,932,409**
Net Interest Income	**1,206,115,509**	**1,397,273,217**

a. Net Income from Sri Lanka Government Securities

	2012 Rs.	2011 Rs.
Interest Income	30,051,668	27,125,709
(Less) : Interest Expenses	-	-
Net Interest Income	**30,051,668**	**27,125,709**

2. Net Fee and Commission Income

	2012 Rs.	2011 Rs.
Fee and Commission Income	72,580,010	64,510,890
Fee and Commission Expenses	-	-
Net Fee and Commission Income	**72,580,010**	**64,510,890**
Comprising		
Bank Service Charges	66,455,377	57,637,682
Legal & Technical Fees	1,019,010	683,750
Other Loan Charges	5,105,623	6,189,458
Net Fee and Commission Income	**72,580,010**	**64,510,890**

3. Other Operating Income (net)

	2012 Rs.	2011 Rs.
Other Income	-	-
Dividend Income	2,370,750	1,926,500
Sundry Income	4,244,763	9,581,971
Other Operating Income (net)	**6,615,513**	**11,508,471**

NOTES TO THE FINANCIAL STATEMENTS CONTD...

4. Impairment Charges/ (Reversal) for Loans and Other Losses

	2012 Rs.	2011 Rs.
Loans and Receivables - Customers (Note 11)	116,716	16,492,209
Total	**116,716**	**16,492,209**

5. Personnel Expenses

	2012 Rs.	2011 Rs.
Salary and Bonus	293,167,420	264,966,411
Contribution to Defined Contribution Plans	46,951,132	39,837,717
Contribution to Defined Benifit Plans	36,335,795	22,433,531
Other Staff Expenses	139,277,058	60,788,565
Total	**515,731,406**	**388,026,224**

6. Other Expenses

	2012 Rs.	2011 Rs.
Directors' Emoluments	3,000,454	2,577,780
Auditors' Remuneration	559,004	786,423
Professional and Legal Expenses	2,872,018	2,050,000
Depreciation/Amortisation of property, plant and equipment	18,853,871	12,697,987
Office Administration and Establishment Expenses	105,549,901	101,013,244
Others	-	-
Advertising and Promotional Expenses	62,613,840	63,405,287
Motor Vehicle & Travelling	9,151,334	7,624,280
General Expense	12,565,629	13,586,956
District Rep's Commission	226,460	202,750
Other Losses,Bad Debts and Write Offs	505,986	192,886
CBSL Deposit Insurance	14,328,428	13,540,012
Other Expenses	17,030,395	15,961,959
Total	**247,257,319**	**233,639,563**

NOTES TO THE FINANCIAL STATEMENTS CONTD...

7. Tax Expenses

	2012 Rs.	2011 Rs.
Current Tax Expense	156,330,199	176,470,224
Current Year	-	-
Deferred Tax Expense/(Credit)	1,472,090	1,838,697
Total	**157,802,290**	**178,308,921**

a. Reconciliation of tax expenses

	2012 Rs.	2011 Rs.
Profit/(Loss) before Tax (As per Previous SLAS)	325,593,998	731,163,016
Income Tax for the Period (Accounting profit @ 28%)		
Adjustment in respect of Current Income Tax of Prior Periods	-	
Add: Tax effect of Expenses that are not Deductible for tax Purposes	189,978,403	218,667,736
(Less): Tax effect of expenses that are deductible for tax purposes	(66,527,084)	(61,112,084)
Disposal of Assets	150,477	(4,941,050)
Dividends	(2,370,750)	(1,426,500)
Adjusted Profits for the year	446,825,043	882,351,118
Taxation based on Profit for the year	125,111,012	176,470,224
Transfer to/from Deffered Taxation	1,472,090	1,838,697
(Over)/Under Provision in Previous years	31,219,187	
Tax Expense for the Period	**157,802,290**	**178,308,921**

b. The Deferred Tax (credit)/charge in the Income Statement Comprise of the Following.

	2012 Rs.	2011 Rs.
Deferred Tax Assets		
Property, Plant & Equipment	3,096,357	2,135,385
Employee Benefit Obligations	(53,515,533)	(54,026,651)
Deferred Tax (Credit)/Charge to Income Statement	**(50,419,175)**	**(51,891,266)**

NOTES TO THE FINANCIAL STATEMENTS CONTD...

8. Analysis of Financial Instruments by Measurement Basis

a. Bank - Current year (2012)

In Rs.	HTM	Loans & Receivables	AFS	Total
ASSETS				
Cash and Balances with Central Banks		30,932,075		30,932,075
Sri Lanka Government Securities	296,742,675			296,742,675
Balances with banks				-
Investment securities			5,379,078	5,379,078
Placement with and Loans to other Banks & Financial Institutions				-
Commercial Papers		480,514,166		480,514,166
Trust Certificates		-		-
Treasury Bills Held Under Resale Agreement		-		-
Fixed Deposits		2,729,205,101		2,729,205,101
Debentures		40,000,000		40,000,000
Loans and Receivables to Other Customers		18,315,422,376		18,315,422,376
Financial Investments - Pyramid Trust			14,265,000	14,265,000
Other Assets -Prepaid Staff Loans		234,190,448		234,190,448
Total Financial Assets	**296,742,675**	**21,830,264,166**	**19,644,078**	**22,146,650,920**
LIABILITIES				
Due to Banks		23,630,116		23,630,116
Due to Customers				-
Deposits		11,674,252,430		11,674,252,430
Institutional Deposits		4,717,863,301		4,717,863,301
Scheme Deposits		844,447,872		844,447,872
Debt Securities Issued		195,307,192		195,307,192
Other Borrowings				
Government of Sri Lanka		384,321,918		384,321,918
AHF		68,876,288		68,876,288
USAID		3,389,453		3,389,453
Refinance Borrowing		81,995,053		81,995,053
Other Liabilities		276,970,172		276,970,172
Total Financial Liabilities	**-**	**18,271,053,793**	**-**	**18,271,053,793**

Held-to-Maturity - HTM
Available-for-Sale – AFS
Loans and Receivables/Deposits at Amortised Cost - Amortised Cost

NOTES TO THE FINANCIAL STATEMENTS CONTD...

8. Analysis of Financial Instruments by Measurement Basis (Continued)

b. Bank - Previous Year (2011)

In Rs.	HTM	Amortised Cost	AFS	Total
ASSETS				
Cash and Balances with Central Banks		32,760,719		32,760,719
Sri Lanka Government Securities -				
Treasury Bills and other Securities	92,284,876			92,284,876
Balances with Banks				-
Investment Securities			5,379,078	5,379,078
Placement with and Loans to other				
Banks & Financial Institutions				
Comprising				
Commercial Papers		427,174,793		427,174,793
Trust Certificates		138,565,487		138,565,487
Treasury Bills Held Under Resale Agreement		1,275,067,523		1,275,067,523
Fixed Deposits		1,978,532,435		1,978,532,435
Debentures		40,000,000		40,000,000
Loans and Receivables to Other Customers		16,210,730,046		16,210,730,046
Financial Investments - Pyramid Trust			15,945,000	15,945,000
Other Assets -Prepaid Staff Loans		149,727,881		149,727,881
Total Financial Assets	**92,284,876**	**20,252,558,883**	**21,324,078**	**20,366,167,838**
LIABILITIES				
Due to Banks		386,205,707		386,205,707
Due to customers				-
Deposits		11,297,769,408		11,297,769,408
Institutional Deposits		2,966,838,439		2,966,838,439
Scheme Deposits		823,441,844		823,441,844
Debt Securities Issued		195,307,192		195,307,192
Other Borrowings				
Government of Sri Lanka		384,321,918		384,321,918
USAID		7,770,191		7,770,191
Refinance Borrowing		80,830,371		80,830,371
Other Liabilities		322,383,035		322,383,035
Total Financial Liabilities	**-**	**16,464,868,105**	**-**	**16,464,868,105**

9. Cash and Cash Equivalents

	2012 Rs.	2011 Rs.
Cash and Balances with Banks	30,932,075	32,760,719
Total	**30,932,075**	**32,760,719**

NOTES TO THE FINANCIAL STATEMENTS CONTD...

10. Placements with Banks

	2012 Rs.	2011 Rs.
Placements		
Others		
Commercial Paper	480,514,166	427,174,793
Treasury Bills Held Under Resale Agreement	-	1,275,105,427
Debentures	40,000,000	40,000,000
Trust Certificates	-	138,565,487
Fixed Deposits	2,729,205,102	1,978,532,435
Total	**3,249,719,268**	**3,859,378,141**

11. Loans and Receivables to Customers

	2012 Rs.	2011 Rs.
Gross Loans and Receivables	18,453,760,281	16,308,930,321
(Less): Individual Impairment Charges	-	-
Collective Impairment Charges	(138,337,905)	(138,454,221)
Net Loans and Receivables	**18,315,422,376**	**16,170,476,100**

a. Analysis

	2012 Rs.	2011 Rs.
By Product		
Mortgage	6,520,663,314	5,738,302,001
EPF	9,345,488,107	8,589,781,216
Vehicle	48,719,545	-
Staff Loans	419,864,101	445,122,541
Personal Loans	637,909,931	-
Others	1,481,115,283	1,535,724,563
Gross Total	**18,453,760,281**	**16,308,930,321**
By Industry		
Construction of Houses	7,772,323,302	7,146,529,121
Home Improvements	5,263,923,586	4,849,443,327
Purchase of Building Sites	125,755,775	86,412,210
Purchase of Houses	3,016,895,582	2,574,799,591
Agriculture	395,968,955	732,421,963
Personal loans	672,455,624	-
Purchase of Agricultural Vehicles	61,730,180	1,246,999
Other	1,144,707,278	918,077,111
Gross Total	**18,453,760,281**	**16,308,930,321**
Collective Impairment Charges		
Opening balance at 01/01/2012	138,454,221	121,962,012
Charge/(Write back) to income statement	(116,316)	16,492,209
Closing Balance at 31/2/2012	138,337,905	138,454,221
Total	**138,337,905**	**138,454,221**

NOTES TO THE FINANCIAL STATEMENTS CONTD...

12. Financial Investments-Available-for-Sale (Excluding Sri Lanka Government Securities)

	2012 Rs.	2011 Rs.
Equity Securities- Unit Trust	14,265,000	15,945,000
Unquoted Shares	5,379,078	5,379,078
(Less): Impairment Charges	-	-
Net Available-for-Sale Investments	**19,644,078**	**21,324,078**

Equity securities- Unit Trust includes a 500,000 units in Eagle Growth & Income Fund which were carried at cost under SLAS.These investments were recorded at fair value based on the market prices as at the date of the financial statements.Unquoted shares represent the shares in Fitch Rating Lanka Ltd and Credit Information Bureau the values of which cannot be realiably measured. These are carried at Directors' valuation.

13. Financial Investments-Held to Maturity

	2012 Rs.	2011 Rs.
Debt Securities - Treasury Bills	296,742,675	92,359,085
(Less): Impairment Charges	-	-
Net Held to Maturity Investments	**296,742,675**	**92,359,085**

NOTES TO THE FINANCIAL STATEMENTS CONTD...

14. Property, Plant and Equipment

In Rs.	Vehicles	Furniture and Equipment	Total
2012(Current year)			
Cost/Fair Value			
Opening Balance as at 01/01/2012	46,074,449	110,051,827	156,126,276
Additions		12,017,802	12,017,802
Disposals	(30,310)	(6,753,579)	(6,783,889)
Adjustments			-
Closing balance at 31/12/2012	**46,044,139**	**115,316,050**	**161,360,189**
(Less): Accumulated depreciation			
Opening balance at 01/01/2012	22,979,895	75,157,290	98,137,185
Charge for the year	6,487,988	12,365,883	18,853,871
Additions			-
Disposals	(30,310)	(6,355,815)	(6,386,125)
Adjustments			
Closing Balance at 31/12/2012	**29,437,573**	**81,167,358**	**110,604,931**
(Less): Impairment charges			
Net Book Value at 31/12/2012	**16,606,566**	**34,148,692**	**50,755,258**
2011(Previous year)			
Cost/Fair Value			
Opening Balance at 31/12/2012	29,569,589	98,752,185	128,321,774
Additions	20,183,654	11,380,596	31,564,250
Disposals	(3,678,794)	-	(3,678,794)
Adjustments			-
Closing Balance at 31/12/2011	**46,074,449**	**110,132,781**	**156,207,230**
(Less): Accumulated Depreciation			-
Opening Balance at 01/01/2011	25,190,193	64,008,754	89,198,947
Charge for the year	1,468,496	11,229,490	12,697,986
Additions	(3,678,794)	-	(3,678,794)
Disposals	-	-	-
Adjustments	-	-	-
Closing Balance at 31/12/2011	**22,979,895**	**75,238,244**	**98,218,139**
Net Book Value at 31.12.2011	**23,094,554**	**34,894,537**	**57,989,091**

NOTES TO THE FINANCIAL STATEMENTS CONTD...

15. Deferred Tax Assets/(Liabilities)

	Statement of financial Position		Income Statement	
	2012	2011	2012	2011
Property, Plant & Equipment	(3,096,358)	(2,135,386)	(960,972)	524,746
Employee Benefit Obligations	53,515,533	54,026,652	(511,118)	(2,363,443)
Net Total	**50,419,175**	**51,891,266**	**(1,472,090)**	**(1,838,697)**

Deferred tax has been determined based on the effective tax rate of 28%.

16. Other Assets

	2012 Rs.	2011 Rs.
Cost		
Stationary Stock	11,090,281	6,854,288
Deposits and Prepayments	37,137,214	21,875,505
Prepaid Staff Loans	234,190,448	147,910,584
Others	62,781,208	46,473,440
Total	**345,199,151**	**223,113,817**

17. Due to Banks

	2012 Rs.	2011 Rs.
Bank Overdraft	23,630,116	386,205,707
Total	**23,630,116**	**386,205,707**

18. Due to Customers

	2012 Rs.	2011 Rs.
Total Amount Due to Customers	17,236,563,604	15,088,049,691
Total	**17,236,563,604**	**15,088,049,691**
Analysis		
By Product		
Deposits	11,674,252,430	11,297,769,408
Institutional Deposits	4,717,863,301	2,966,838,439
Scheme Deposits	844,447,872	823,441,844
Total	**17,236,563,604**	**15,088,049,691**

NOTES TO THE FINANCIAL STATEMENTS CONTD...

19. Other Borrowings

	2012 Rs.	2011 Rs.
Debentures	195,307,192	195,307,192
Government of Sri Lanka	384,321,918	384,321,918
AHF	68,876,288	-
USAID	3,389,453	7,770,191
Affordable Housing Finance(Refinance)	81,995,053	80,830,371
Total	**733,889,904**	**668,229,672**

20. Employee Benefit

The Bank measures the Present Value of Defined Benefit Obligation (PVDBO) which is a defined benefit plan with the advice of an actuary using the Projected Unit Credit Method. The actuarial valuation involves making assumptions about discount rate, expected rates of return on assets, future salary increases and mortality rates. Due to the long-term nature of these plans, such estimates are subject to significant uncertainty. All assumptions are reviewed at each reporting date. Accordingly, the employee benefit obligation is based on the actuarial valuation as of 31 December 2012, carried out by Messrs Piyal S. Goonatileke and Associates.
The key assumptions used by the actuary include the following:

	2012	2011
Rate of Interest	13.00%	11.00%
Rate of Salary Increase	8.50%	8.50%
Retirement Age	55-60 years	55-60 years

Gratuity

	2012 Rs.	2011 Rs.
Provision for Gratuity		
Balance at the Beginning of the year	120,596,803	129,037,671
Current Service Cost	6,234,933	-
Interest Cost	12,683,173	-
Benefit Paid	(15,401,879)	(10,432,730)
Acturial (Gains)/ Losses	3,583,694	
Provision for the year	-	7,715,772
Transition Liability/(Assets)	-	(5,723,910)
Total	**127,696,724**	**120,596,803**

Medical

	2012 Rs.	2011 Rs.
Provision for Medical Benefit		
Balance at the Beginning of the Year	72,355,524	72,355,524
Current Service Cost	3,207,693	-
Interest Cost	8,311,953	-
Acturial (Gain)/ Losses	(18,223,081)	-
Benefit Paid	(2,221,909)	-
Total	**63,430,180**	**72,355,524**
Total Employee Benefit Liability	**191,126,904**	**192,952,327**

NOTES TO THE FINANCIAL STATEMENTS CONTD...

21. Other Liabilities

	2012 Rs.	2011 Rs.
Income Tax & Deemed Dividend Tax	18,962,032	135,831,245
NSL,WHT & PAYE Payable	3,100,812	2,937,663
VAT & Debit Tax	33,475	15,364
Accrued Expenditure	64,814,751	69,465,321
Others	276,970,170	322,383,035
Total	**363,881,240**	**530,632,628**

22. Stated Capital/Assigned Capital

	2012 Rs.	2011 Rs.
Authorised Capital	2,000,000,000	2,000,000,000
Contributed Capital	889,812,899	889,812,899

As per the provisions of the State Mortgage and Investment Bank Law No.13 of 1975 and amendments thereto,the authorised capital is Rs.2 Billion.Contributed capital consists of the amounts outstanding on 1st January 1979 of the sums advanced to the Agricultural and Industrial Credit Corporation in terms of section 22 of the Agricultural and Industrial Credit Corporation Ordinance together with the amount of the reserves of the Agricultural and Industrial Credit Corporation and the amounts standing to the credit resrve fund of the Ceylon State Mortgage Bank on 1st January 1979 formed part of the capital of the Bank and all such amounts are deemed to be contributions to the capital of the Bank by the Government.

The Government after the appointment date of 1st January 1979 made a contribution to the capital of the Bank so that the amounts of such contribution together with the amounts referred to the above paragraph amounted to RS.889,812,899 as at 31st Decemebr 2012.

Further ,as per the provisions of the Act ,SMIB may from time to time ,raise such sums of money as further contribution to the capital of the Bank in such a manner as the Bank deems fit,from the Government or any other source what so ever in or outside of the Republic of Sri Lanka and where such sums of money raised from the Government thwy shall be charged on the consolidated fund.

23. Statutory Reserve Fund

	2012 Rs.	2011 Rs.
Opening Balance at 01st January	163,190,403	135,441,590
Transfer During the Period	9,790,932	27,748,813
Closing balance at 31st December	**172,981,335**	**163,190,403**

24. Retained Earnings

	2012 Rs.	2011 Rs.
Opening Balance at 01 st January	1,743,968,971	1,579,826,800
Profit for the year	272,462,438	510,268,984
Transfers to Other Reserves	(118,753,379)	(169,566,813)
Deemed Dividend Tax	(79,262,420)	(176,560,000)
Closing Balance at 31st December	**1,818,415,609**	**1,743,968,971**

NOTES TO THE FINANCIAL STATEMENTS CONTD...

25. Other Reserves

a. Bank - Current year (2012)

	Opening balance at 01/01/2012	Movement/ transfers	Closing balance at 31/12/2012
General Reserve	683,280,000		683,280,000
Capital Reserve	9,176,000	-	9,176,000
Title Indemnity Fund	1,031,000	-	1,031,000
Investment Fund	141,818,000	83,962,447	225,780,447
AFS Reserve	10,945,000	(1,680,000)	9,265,000
Total	**846,250,000**	**83,962,447**	**928,532,447**

b. Bank – Previous year (2011)

	Opening balance at 01/01/2011	Movement/ transfers	Closing balance at 31/12/2011
General Reserve	683,280,000	-	683,280,000
Capital Reserve	9,176,000	-	9,176,000
Title Indemnity Fund	1,031,000	-	1,031,000
Investment Fund	-	141,818,000	141,818,000
AFS Reserve	14,320,000	(3,375,000)	10,945,000
Total	**707,807,000**	**138,443,000**	**846,250,000**

Investment Fund Account is established and operated based on the Guidelines on the Operations of the Investment Fund Account issued by the Central Bank of Sri Lanka on 29 April 2011 with the concurrence of the Commissioner - General of Inland Revenue.

26. Contingent Liabilities and Commitments

	2012 Rs.	2011 Rs.
Guarantees issued	-	-
Other commitments		
Total	-	-

In the normal course of business,the Bank makes various commitments and incurs certain contingent liabilties with legal recourse to its customers.No material losses are anticipated as a result of these transactions.

NOTES TO THE FINANCIAL STATEMENTS CONTD...

27. Transactions with Key Management Personnel(KMPs)

According to Sri Lanka Acccounting Standard 30 (Revised 2005) - 'Related Party Disclosure',the Key Management Personnel includes those who are having authority and responsibility for planning,directing and controlling the activities of the Bank and its subsidiaries and Associates.The Board of Directors,Members of the Corporate Management of the Bank,key employees and their Close Family Members(CFM) have been classified as Key Management Personnel of the Bank.

27.1 (A) Compensation to Key Management Personnel

	2012	2011
Short - Term Employment Benefits	30,631,691.23	26,744,468
Post - Employment Benefits	1,073,376	4,538,950
Total	**31,705,067**	**31,283,418**

27.1 (B) Transactions ,arrangements and agreements involving Key Management Personnel ,their Close Family Members (CFMs) and entities that are controlled,significantly influenced by the KMPs or their CFMs.

	2012	2011
Income Statement		
Interest Earned	1,344,800	340,052
Interest Paid	592,891	1,471,997
Payment made as shown in 5.1 A	31,705,067	31,283,418
Balance Sheet		
Assets		
Loans and Advances	33,771,236	28,032,820
Liabilities		
Deposits	8,901,430	2,548,224

NOTES TO THE FINANCIAL STATEMENTS CONTD...

28. Fair Value of Financial Instruments

Financial instruments recorded at fair value

The following is a description of how fair values are determined for financial instruments that are recorded at fair value using valuation techniques. These incorporate the bank's estimate of assumptions that a market participant would make when valuing the instruments.

Financial Investments – Available For sale

Available for sale financial assets include an investment in unit trust which has been valued using the market data.

28.1 Determination of fair value and fair value hierarchy

The bank uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique

Level 1: Quoted (unadjusted) prices in active markets for identical assets or liabilities

Level 2: Other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly

Level 3: Techniques which use inputs that have a significant effect on the recorded fair value that are not based on observable market data

The following table shows an analysis of financial instruments recorded at fair value by level of the fair value hierarchy:

31st December 2012	Level 1 Rs	Level 2 Rs	Level 3 Rs	Total Rs
Financial Assets				
Financial investments available for sale				
Quoted investments - Unit Trust	14,265,000			14,265,000
Total Financial Assets	**14,265,000**			**14,265,000**
Financial Liabilities	-	-	-	-
Total Financial Liabilities	-	-	-	-

Determination of fair value and fair value hierarchy - continued

Set out below is a comparison, by class, of the carrying amounts and fair values of the Bank's financial instruments that are not carried at fair value in the Financial Statements. This table does not include the fair values of non–financial assets and non–financial liabilities.

NOTES TO THE FINANCIAL STATEMENTS CONTD...

	2012	
	Carrying amount Rs.	Fair Value Rs.
Assets		
Cash and cash equivalents	30,932,075	30,932,075
Placements with banks	3,249,719,267	3,254,147,295
Loans and receivables to customers	18,315,422,376	18,315,422,376
Financial investments – Available-for-sale	5,379,078	5,379,078
Financial investments – Held-to-maturity	296,742,675	296,742,675
Other assets	234,190,448	307,335,526
Total Financial Assets	**22,132,385,920**	**22,209,959,026**
Liabilities		
Due to banks	23,630,116	23,630,116
Due to customers	17,236,563,604	17,240,987,633
Other borrowings	733,889,904	733,889,904
Other liabilities	276,970,172	276,970,172
Total Financial Liabilities	**18,271,053,796**	**18,275,477,825**

Fair Value of Financial Assets and Liabilities not Carried at Fair Value

The following describes the methodologies and assumptions used to determine the fair values for those financial instruments which are not already recorded at fair value in the Financial Statements.

Assets for which Fair Value Approximates Carrying Value

For financial assets and financial liabilities that have a short term maturity (original maturities less than a year), it is assumed that the carrying amounts approximate their fair values. This assumption is also applied to savings deposits without a specific maturity. Long term deposits accepted from customers for which periodical interest is paid and loans and advances granted to customers with a variable rate are also considered to be approximately carried at fair value in the books.

Fixed Rate Financial Instruments

Carrying amounts are considered as fair values for short term credit facilities. The Placement with Banks includes Repurchase agreements,commercial Papers with tenors less than one year.The Debenture of Rs.40,000,000 has not been fair valued.In fair valuing held to maturity securities, rates published by the CBSL for similar trading securities were used.The Bank grants Loans and Receivables with the right of revision of the interest rate at its discretion.Conversely, fixed deposits with original tenures above one year and interest paid at maturity were discounted using current market rates offered to customers during the fourth quarter of the reporting year.Loans and advances since they are granted with the option of repricing are onsidered as carrying value equals the fair value.

29. Risk Management

29.1 Introduction and Overview

The bank is exposed to the following risks from business operation.

- credit risk
- liquidity risk
- market risk
- operational risk

The bank's exposure to the above risk categories are discussed in detail in the management discussion on Risk Management of SMIB. Followings facts are highlighted in the notes to the account.

NOTES TO THE FINANCIAL STATEMENTS CONTD...

Risk Management Structure

The Board of Directors has overall responsibility for the establishment and oversight of the Bank's risk management framework. In discharging its governance responsibility, it operates through two key committees, ie. the Board Integrated Risk Management Committee and the Audit Committee.

The board and the BIRMC have delegated the risk management responsibility to the following executive management committees in co-ordination of risk matters for each of the focused areas.

- Executive Integrated Risk Management Committee
- Credit Committee
- Asset and Liability Committee (ALCO)
- IT Steering Committee

Bank Treasury is responsible for managing the bank's assets and liabilities and the overall financial structure.It is also primarily responsible for the funding and liquidity risks of the bank.

29.2 Credit risk

Credit risk arises from the potential that an obligor is either unwilling to perform on an obligation or its ability to perform such obligation is impaired resulting in economic loss to the bank. This is the primary category of risk with which the bank must deal, since the major share of its assets consists of loans and advances.

The credit risk policy plays a central role in managing daily business activities. The Bank has developed a policy which defines the principles encompassing client selection, due diligence, early alert reporting, tolerable levels of concentration risk and portfolio monitoring in line with Bank's risk appetite. The policy is reviewed at least annually and approved by the Board of Directors ensuring consistency with the Bank's business strategy.

Consistant standards maitained in initial screening and credit appraisal process,indipendent risk recommendation ,delegation of authority for loan sancton process are some of the methods used for credit risk mitigation.Colaterlas obtained are valued periodically as per regulator's guidelines.Loan review mechanism carried out by the risk management department of the bank ensures early identification of problem loans to safeguard the bank against possible losses.

Impairment Assessment

For accounting purposes, the Bank uses an incurred loss model for the recognition of losses on impaired financial assets. This means that losses can only be recognized when objective evidence of a specific loss event has been observed. Triggering events include the following,

- Significant financial difficulty of the customer
- A breach of contract such as a default of payment
- Where the bank grants the customer a concession due to the customer experiencing financial difficulty
- It becomes probable that the customer will enter bankruptcy or other financial reorganisation
- Observable data that suggests that there is a decrease in the estimated future cash flows from the loans

Individually Assessed Allowances

The Bank determines the allowances appropriate for each individually significant loan or advance on an individual basis, including any overdue payments of interests, credit rating downgrades, or infringement of the original terms of the contract. Items considered when determining allowance amounts include the sustainability of the counterparty's business plan, its ability to improve performance if it is in a financial difficulty, projected receipts and the expected payout should bankruptcy ensue, the availability of other financial support, the realizable value of collateral and the timing of the expected cash flows. Impairment allowances are evaluated at each reporting date, unless unforeseen circumstances require more careful attention.

NOTES TO THE FINANCIAL STATEMENTS CONTD...

Collectively assessed allowances

Allowances are assessed collectively for losses on loans and advances that are not individually significant and for individually significant loans and advances that have been assessed individually and found not to be impaired.

The Bank generally bases its analyses on historical experience. However, when there are significant market developments, the Bank would include macro- economic factors within its assessments. These factors include, depending on the characteristics of the individual or collective assessment: unemployment rates, levels of bad debts and delinquency trends, Inflation, movements in Gross Domestic Product (GDP), macro environment stability in Financial industry, revisions in the Interest rates, changes in Regulatory Environment and other consumer data. The Bank may use the aforementioned factors as appropriate to adjust the impairment allowances.

Allowances are evaluated separately at each reporting date with each portfolio.

The collective assessment is made for groups of assets with similar risk characteristics, in order to determine whether provision should be made due to incurred loss events for which there is objective evidence, but the effects of which are not yet evident in the individual loans assessments. The collective assessment takes account of data from the loan portfolio (such as historical losses on the portfolio, levels of arrears, credit utilisation, loan to collateral ratios and expected receipts and recoveries once impaired) or economic data (such as current economic conditions, unemployment levels and local or industry–specific problems). The approximate delay between the time a loss is likely to have been incurred and the time it will be identified as requiring an individually assessed impairment allowance is also taken into consideration. Local Management is responsible for deciding the length of this period, which can extend for as long as one year. The impairment allowance is then reviewed by credit management to ensure alignment with the bank's overall policy.

The loans are impaired using risk migrtion method.

Collateral and other credit enhancements

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty.
Guidelines are in place covering the acceptability and valuation of each type of collateral.

The main types of collateral obtained are as follows

The Bank obtains mortgages over residential properties for lending.

It is the bank's policy to dispose of repossessed properties in an orderly fashion. The proceeds are used to reduce or repay the outstanding claim. In general, the bank does not occupy repossessed properties for business use.

Analysis of Risk Concentration

The Bank's concentrations of risk are managed by industry sector. The following table shows the risk concentration by industry for the components of the statement of financial position. Within the assets concentrated as "Other" include agricultural loans.

NOTES TO THE FINANCIAL STATEMENTS CONTD...

Industry analysis

31-Dec-12	Financial Services Rs.million	Government Rs.million	Construction and Housing Rs.million	Consumers Rs.million	Agriculture Rs.million	Other Rs.million	Total Rs.million
Financial Assets							
Cash and cash equivalents	30,932,075						30,932,075
Placement with other banks	3,249,719,267						3,249,719,267
Loans and receivables to customers	-						
Mortgage			6,520,663,314				6,520,663,314
EPF			9,345,488,107				9,345,488,107
Vehicle				48,719,545			48,719,545
Staff loans			419,864,101				419,864,101
Personal Loans				637,909,931			637,909,931
Others						1,481,115,283	1,481,115,283
Impairment Charge							-
Net Loans and Advances							-
Financial investments – Available-for-sale	19,644,078						19,644,078
Financial investments – Held-to-maturity		296,742,675					296,742,675
	3,300,295,420	**296,742,675**	**16,286,015,522**	**686,629,476**	**-**	**1,481,115,283**	**22,050,798,376**

28.3 Liquidity Risk and Funding Management

Liquidity risk is defined as the risk that the bank will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset. Liquidity risk arises because of the possibility that the bank might be unable to meet its payment obligations when they fall due under both normal and stress circumstances. To limit this risk, management has arranged diversified funding sources in addition to its core deposit base, and adopted a policy of managing assets with liquidity in mind and monitoring future cash flows and liquidity on a daily basis. The bank has developed internal control processes and contingency plans for managing liquidity risk.

Liquidity Ratios

Liquid assets mainly consists of cash,balances with banks and government securities.
The bank monitors the following liquidity ratios to assess funding requirement.

	2012	2011
Liquid Asset Ratio		
Year–end	21.98	20.04
Maximum	26.11	27.69
Minimum	18.22	19.47
Average	22.88	21.23

Refer to the note on Risk Management in Page 20.

The bank stresses the importance of deposit accounts as sources of funds to finance lending to customers. They are monitored using the advances to deposit ratio, which compares loans and advances to customers as a percentage of customer savings accounts, together with term funding .

NOTES TO THE FINANCIAL STATEMENTS CONTD...

Analysis of Financial Assets and Liabilities by Remaining Contractual Maturities

The table below summarises the maturity profile of the undiscounted cash flows of the bank's financial assets and liabilities as at 31 December.

Contractual maturities of undiscounted cash flows of financial assets and liabilities

The table below summarizes the maturity profile of the undiscounted cash flows of the Bank's financial assets and liabilities as at 31 December 2012.

As at 31 December 2012

	Less than 7 Days Rs.'000	7-30 Days Rs.'000	1-3 Months Rs.'000	3-6 Months Rs.'000	6-12 Months Rs.'000	1-3 Years Rs.'000	3-5 Years Rs.'000	Over 5 Years Rs.'000	Unclassified	Total
Cash	13,185,960									13,185,960
Due from Banks	17,746,115									17,746,115
Invesment Currents	151,263,526	355,614,328	1,391,948,150	490,211,177	1,157,424,756			19,644,078		3,566,106,022
Invesment Non performing	0									
Loan & Advances Current	7,624,000	198,489,000	323,013,000	313,511,000	652,657,000	2,233,280,003	2,154,264,000	5,527,933,640		11,410,771,643
Loan & Advances NPL									6,904,650,733	6,904,650,733
Fixed Assets								50,755,258		50,755,258
Other Assets	0	11,229,585	12,915,866	2,774,823	283,052,216	13,486,000	2,304,000	69,855,837		395,618,326
Total Assets	**189,819,601**	**565,332,913**	**1,727,877,016**	**806,497,000**	**2,093,133,971**	**2,246,766,003**	**2,156,568,000**	**5,668,188,813**	**6,904,650,733**	**22,358,834,058**
Total Capital Fund								3,809,742,291		3,809,742,291
Deposits	996,712,620	1,394,611,179	4,402,573,990	1,844,227,636	5,972,296,953	1,449,443,519	34,994,602	1,111,473,635	30,229,469	17,236,563,604
Borrowings	23,630,116	1,409,000	1,476,000	4,614,000	7,992,000	109,400,000	134,550,000	474,449,110		757,520,226
Other Liabilities	380	230,215,821	88,239,010	75,364	31,306,047	18,812,481	20,533,398	165,825,437		555,007,937
Total Liabilities	**1,020,343,116**	**1,626,236,000**	**4,492,289,000**	**1,848,917,000**	**6,011,595,000**	**1,577,656,000**	**190,078,000**	**5,561,490,473**	**30,229,469**	**22,358,834,058**

NOTES TO THE FINANCIAL STATEMENTS CONTD...

29.4 Market Risk and Operational Risk

As discussed in the Risk Mangement -Management discussion

29.5 Capital Management

Regulatory Capital
Licensed Specialised banks in Sri Lanka need to maintain a minimum Capital Adequacy Ratio (CAR) of 10% and a Core Tier 1 Capital Ratio of at least 5%.

Capital Adequacy
The bank computes CAR as a ratio of its capital to its risk weighted assets. Calculations of the risk weightings defined under credit risk and market risk are based on the standardised approach whereas operational risk is computed by using the basic indicator approach.

As of 31st December 2012, SMIB reported a Tier 1 ratio and a total CAR of 33.22% which remain comfortably above the CBSL's capital requirements.

29.6 Market Risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as interest rates, foreign exchange rates and equity prices. The bank does not posess any trading portfolios at present and hence the Bank's portfolio is mainly non trading.

29.6.1 Market risk – non–trading

Interest rate risk
Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair values of financial instruments.

The bank's policy is to monitor positions on a daily basis and hedging strategies are used to ensure positions are maintained within the established limits.

Prepayment risk
Prepayment risk is the risk that the bank will incur a financial loss because its customers and counterparties repay or request repayment earlier or later than expected, such as fixed rate mortgages when interest rates fall.

29.7 Operational Risk

Operational risk is the risk of loss arising from systems failure, human error, fraud or external events. When controls fail to operate effectively, operational risks can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. The bank cannot expect to eliminate all operational risks, but it endeavours to manage these risks through a control framework and by monitoring and responding to potential risks.

Controls include effective segregation of duties, access, authorisation and reconciliation procedures, staff education and assessment processes, such as the use of internal audit.

NOTES TO THE FINANCIAL STATEMENTS CONTD...

30 Maturity Gap Analysis

	Less than 7 days	7-30 days	1-3 months	3-6 months	6-12 months	1-3 years	3-5 years	Over 5 years	Unclassified	Total
Total Assets	189,819,601	565,332,913	1,727,877,016	806,497,000	2,093,133,979	2,246,766,003	2,156,568,000	5,668,188,813	6,904,650,733	22,358,834,058
Cash	13,185,960									13,185,960
Due from Banks	17,746,115									17,746,115
Invesment Currents	151,263,526	355,614,328	1,391,948,150	490,211,177	1,157,424,764			19,644,078		3,566,106,022
Invesment Non performing										
Loan & Advances Current	7,624,000	198,489,000	323,013,000	313,511,000	652,657,000	2,233,280,003	2,154,264,000	5,527,933,640		11,410,771,643
Loan & Advances NPL									6,904,650,733	6,904,650,733
Fixed Assets								50,755,258		50,755,258
Other Assets		11,229,585	12,915,866	2,774,823	283,052,216	13,486,000	2,304,000	69,855,837		395,618,326
Total Liabilities	1,020,343,116	1,626,236,000	4,492,289,000	1,848,917,000	6,011,595,000	1,577,656,000	190,078,000	5,561,490,473	30,229,469	22,358,834,058
Total Capital Fund								3,809,742,291		3,809,742,291
Deposits	996,712,620	1,394,611,179	4,402,573,990	1,844,227,636	5,972,296,953	1,449,443,519	34,994,602	1,111,473,635	30,229,469	17,236,563,604
Borrowings	23,630,116	1,409,000	1,476,000	4,614,000	7,992,000	109,400,000	134,550,000	474,449,110		757,520,226
Other Liabilities	380	230,215,821	88,239,010	75,364	31,306,047	18,812,481	20,533,398	165,825,437		555,007,937
Maturity Gap	(830,523,516)	(1,060,903,087)	(2,764,411,984)	(1,042,420,000)	(3,918,461,021)	669,110,003	1,966,490,000	106,698,340	6,874,421,264	
cumilative M.Gap		(1,891,426,603)	(4,655,838,587)	(5,698,258,587)	(9,616,719,607)	(8,947,609,604)	(6,981,119,604)	(6,874,421,264)		

NOTES TO THE FINANCIAL STATEMENTS CONTD...

31. The Events Occuring After the Balance Sheet Date

There have been no materrial events occuring after the balance sheet date that require adjustments to or disclosure in the Fin ancial Statements.

32. Assets Pledged

No assets have been pledged as security for liability.

33. Related Party Transactions

State Mortagage and Investment Bank is a state controlled enterprise.In the normal course of business it engages in transactions with other state controlled enterprises which are not disclosed in line with paragrapgh 4(d) of Sri Lanka Accounting Standard No.30 Related Parties.

34. Directors' Interest in Contracts and Proposed Contracts

As per the State Mortgage and Investment Bank law, No 13 of 1975, a Director who, or whose spouse or dependent child, is directly or indirectly interested in any business transacted or proposed to be transacted by the Board shall disclose the nature of such interest discussed. The disclosure shall be recorded in the minutes of the Board, and such Director shall not take part in any deliberation or decision of the Board with respected with that business, and shall withdraw from such meeting while such deliberation is in progress or decision is being made.

As per the Act, No loan shall be granted by the bank to any Director or employee of the bank or to the spouse or a dependant child of a Director or employee or to any company or firm in which a Director or employee has a substancial interest: “Provided however that the bank may grant to its employees loans for the purchase of any land for the construction of a dwelling house or for the purchase, construction, repair, renovation of or any extention to, a dwelling house or for any other purpose prescibed by the rules made under this law. Outstanding balance of loans given to employees as per this paragraph is disclosed on page 96 of this report under Note - 11 Loans and advances. The Directors of SMIB were not directly or indirectly interested in the contracts with SMIB during the year ended December 31, 2012.

CAPITAL ADEQUACY

Rs '000			Risk Weighted Balance	
	31.12.2012	31.12.2011	31.12.2012	31.12.2011
Cash	13,186	24,805	-	-
Treasury Bill and other securities eligible for Re-Discounting with Central Bank	296,743	92,359	-	-
Securities Purchased under Re-Sale Agreement	-	1,275,105	-	-
Claims on Financial Instituitions	500,158	587,064	115,746	134,472
Claims on Central Bank of Sri Lanka	94,759	352,574	-	-
Claims on Public Sector Entities	221,647	106,688	221,647	106,688
Claims on Banks Exposure	2,769,205	2,018,532	565,841	415,706
Loans against Cash Deposit	357,933	369,190	-	-
Loans Gauranteed by CBSL	9,345,488	8,589,781	-	-
Secured by a Primary Mortgage over Pesidential Property	6,382,325	5,599,848	6,382,325	5,599,848
Other Loans and Advances	1,913,270	1,152,395	1,913,270	1,152,395
Due from Local Banks	17,746	7,956	3,550	1,591
Property, Plant and Equipment	50,755	57,989	50,755	57,989
Other Assets	395,618	275,005	395,618	275,005
Total Assets	**22,358,833**	**20,509,291**	**9,648,752**	**7,743,694**

Basis of Computation

The Risk weights assigned on Balancesheet assests and compositions of capital are prescribed by the Central Bank.

	31.12.2012.	31.12.2011
Total Risk Weighted Assets for Credit Risk	9,648,752	7,743,694
Total Risk Weighted Assets for Operational Risk	1,790,405	1,350,478
Total Risk Weighted Assets	11,439,157	9,094,172
Core Capital%	33.22	39.94
Total Risk Weighted Capital Ratio %	33.22	39.94

SOURCES AND UTILISATION OF INCOME

For the Year Ended at 31st December	2012 Rs.	2011 Rs.
Sources of Income		
Loans and Advances	2,458,414,243	2,314,895,514
Government Securities	472,898,011	296,310,112
Fee and Commission Income	72,580,010	64,510,890
Other Income	6,615,513	11,508,471
Total	**3,010,507,777**	**2,687,224,987**
Utilisation of Income		
Employees		
Salaries and other payment to staff	515,731,406	388,026,224
Suppliers		
Interest paid	1,725,196,745	1,213,932,409
Other Expenses	339,314,898	396,688,586
Government		
Corporate Taxes	157,802,290	178,308,921
Deemed Dividends	79,262,420	176,560,000
Payment to consolidated Fund	25,000,000	
Retained Profit	168,200,018	333,708,848
Total	**3,010,507,777**	**2,687,224,987**

TEN YEAR SUMMARY

Year ended 31st December (Rs.Million)	2012*	2011	2010	2009	2008	2007	2006	2005	2004	2003
Income Statement										
Interest Income	2,931	2,603	2,709	2,636	2,102	1,532	1,379	1,213	1,233	1,305
Interest Expenditure	1,725	1,214	1,368	1,939	1,636	1,002	608	468	468	596
	1,206	1,389	1,341	697	466	530	771	745	765	709
Other Operating Income	79	76	41	36	120	39	47	28	31	23
	1,285	1,465	1,382	733	586	569	818	773	796	732
Non Interest Expenses	855	735	740	612	535	445	500	359	414	304
Net Profit before Tax	430	731	642	120	51	124	318	414	382	428
Taxation	158	176	179	46	30	41	105	102	54	85
Net Profit after Tax	272	555	463	74	21	83	213	312	328	343
Assets										
Investement Securities	14	5	5	5	1	1	1	1	1	1
Loans and Advances	18,315	15,469	13,670	13,433	13,142	10,995	9,488	8,475	8,079	7,193
Other Assets	3,979	4,295	3,531	3,368	1,336	1,219	679	663	770	963
Propery,Plant and Rquipment	50	58	39	40	37	37	30	31	22	27
Total Assets	22,358	19,827	17,245	16,846	14,516	12,252	10,198	9,170	8,871	8,922
Fund Employed										
Capital Contributed	890	890	890	890	890	890	890	890	890	890
Reserves	2,920	2,138	1,763	1,480	1,507	1,634	1,597	1,507	1,461	1,337
Liabilities										
Deposits	17,237	14,390	12,506	12,350	10,174	7,517	5,663	4,690	4,605	4,922
Debentures	195	195	195	250	250	250	250	250	-	-
Other Liabilities	1,116	2,214	1,891	1,876	1,695	1,961	1,798	1,833	1,915	1,773
Total Liabilities	22,358	19,827	17,245	16,846	14,516	12,252	10,198	9,170	8,871	8,922
Ratio										
Return on Average Assets-NPBT%	2	4	4	1	0	1	3	5	4	5
Return on Average Funds Employed%	7	20	18	3	1	3	13	13	14	16
Number of Employees(no.)	323	302	308	320	328	345	349	304	311	319
Net Profit per Employee	1	2	2	0	0	0	1	2	1	1
Statutory Reserve Fund	173	163	135	112	109	106	102	92	76	60
Advances to Deposits(Times)	1	1	1	1	1	1	2	2	2	2
Interest Cover(Times)	1	2	1	1	1	1	2	2	2	2
Debt to Equity Ratio(Times)	0	0	0	0	0	0	1	0	1	1
Equity Assets Ratio(Times)	0	0	0	0	0	0	0	0	0	0
Total Assets per Rupee Contributed	25	22	19	19	16	14	10	10	10	10
Effective Deemed Dividend Rate%	20	20	20	6	3	2	11	11	6	8
Deemed Dividend Cover	3	3	3	1	1	4	2	3	6	5
Our Contribution to the Nation										
Deemed Dividend Tax	80	177	180	52	30	21	97	96	55	72
Payments to Consolidated Fund	25	-	-	50	-	25	25	126	150	50

* Based on New Sri Lanka Accounting Standards

VALUE ADDED STATEMENT

For the Year Ended at 31st December	2012 Rs.	2011 Rs.
Interest Income	2,931,312,254	2,611,205,626
Other Income	79,195,523	76,019,361
Total	**3,010,507,777**	**2,687,224,987**
Interest Expenses	(1,725,196,745)	(1,213,932,409)
Cost of Services	(321,301,969)	(367,498,391)
(Provision)/Reversal for Impairment	116,716	(16,492,209)
	964,125,779	**1,089,301,978**

Distribution of Value Added

For the year ended at 31st December	2012 Rs.	2011 Rs.
To Emplyees		
Salaries and other benefits	515,731,406	388,026,224
To Government		
Corporate Tax	157,802,290	178,308,920
Deemed Dividends	79,262,240	176,560,000
Payment to Consolidated Fund	25,000,000	
To Expansion and Growth		
Depreciation	18,853,871	12,697,986
Retained Profit	168,200,018	333,708,848
	964,850,005	**1,089,301,978**

Corporate Information

Name of the Bank
State Mortgage & Investment Bank

Legal Form
A body corporate Incorporated under the State Mortgage & Investment Bank Law No. 13 of 1975

Registered Office
No.269, Galle Road, Colombo 03, Sri Lanka.

Head Office
269, Galle Road, Colombo 03.
Tel; 011-2573561, 011-7722722-3
Fax......... 011-2573346
E-Mail: agmit@smib.lk
Web: www.smib.lk

Kandy Branch
No. 61,1st Floor, King's Street, Kandy.
Tel: 081 7722722/3, 081 2222819
kandy.mgr@smib.lk

Gampaha Branch
No.232,Colombo Rd, Gampaha.
Tel: 033 7722722/3, 033 2221317
gampaha.mgr@smib.lk

Galle Branch
No.119,Wakwella Road, Galle.
Tel: 091 7722722/3, 091 2246788
galle.mgr@smib.lk

Kurunegala Branch
No.21,1st Floor, Atulakure building, Dambulla Rd, Kurunagala.
Tel: 037 7722722/3, 037 2231234
kurunegala.mgr@smib.lk

Matugama Branch
No.441, Agalawatta Road, Mathugama.
Tel: 034 7722722/3, 034 2243714
matugama.mgr@smib.lk

Matara Branch
No.45A1/1 1st Floor, Dharmapala Mw, Matara.
041 7722722/3, 041 2222204
matara.mgr@smib.lk

Chilaw Branch
No.15A,Bishop Edmand Peiris Mw, Chilaw.
Tel - 032 7722722/3, 032 2223996
chilaw.mgr@smib.lk

Kegalle Extension Office
No.82, Main Street, Kegalle.
Tel: 035 7722722/3, 0352222877
kegalle.mgr@smib.lk

Kiribathgoda Extension Office
No.63, Kandy Rd, Kiribathgoda.
Tel: 011 7723575/6, 0112908833
kiribathgoda.mgr@smib.lk

Battaramulla Extension Office
No.108, Main Street, Battaramulla.
Tel: 011 7723570/1, 0112882144
battaramulla.mgr@smib.lk

Horana Extension Office
No. 45, Rathnapura Rd, Horana.
Tel: 034 7722733/4, 0342265400
horana.mgr@smib.lk

Ambalantota Extension Office
No.122,Main Street, Ambalantota.
Tel: 047 7722722/3, 047 2225516
ambalantota.mgr@smib.lk

Batticaloa Extension Office
No.44, Station Rd, Batticoloa.
Tel: 065 7722722/3, 0652228480
batticaloa.mgr@smib.lk

Jaffna Extension Office
No.127, Stanley Rd, Jaffna.
Tel: 021 7722722/3, 0212220263
jaffna.mgr@smib.lk

Vavniya Extension Office
Divisional Sec.Office, Tamil Division, Vauniya.
Tel: 024 7722722/3
vavuniya.mgr@smib.lk

Board of Directors

Mr. Jagat Wellawatta	-	Chairman
Mr. V.M. Ameen	-	Director
Mr. D. Weerasekara	-	Director
Mr. V.S. Bandara	-	Director
Mr. M.Y.M. Shamraz	-	Director
Mr. S. Hycinth	-	Director
Mr.S.L.G.Bandusiri	-	Director
Mr.P.H.L.W.Perera	-	Director

General Manager
Miss. Wasantha Geeganage - Acct. General Manager

Board Secretary
Mrs. S.V.P. Cooray

Audit Committee

Mr. V.M. Ameen	-	Chairman
Mr. V.S. Bandara	-	Director
Mr. S. Hycinth	-	Director
Mr.S.L.G.Bandusiri	-	Director

Auditors
Auditor General,
Auditor General's Department,
Colombo 07.

Principal Lines of Business
Provision of Housing Finance, Agriculture and Industrial Credit, Mobilizing terms and saving deposits, corporate Investments

State Mortgage & Investment Bank

No. 269, Galle Road, Colombo 03.

Visit : www.smib.lk **| Mail :** info@smib.lk **| Dial :** 011 – 7722722

Designed & Printed by Ceylon Printers PLC