

## Circulars Issued by BSD in 2004

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Department of Bank Supervision  
31 December 2004

To: All Licensed Commercial Banks and  
Licensed Specialised Banks;  
Approved Auditors

Dear Sirs

**Accounting for Properties Acquired by  
Foreclosure of Collateral/Part Settlement of Debt**

It has been observed that the accounting treatment adopted by some banks with respect to immovable property acquired by foreclosure of collateral from defaulting customers or which have devolved on the banks as part settlement of debt, leads to a misrepresentation of the bank's assets and the level of non-performing advances of the bank.

2. In order to create a uniform practice among the banks in accounting for such assets, and to avoid misrepresentation of the level of non-performing advances, all banks are hereby informed to adhere to the following procedure in accounting for such property:

2.1 Immovable property acquired by foreclosure of collateral from defaulting customers, or which have devolved on the banks as part settlement of debt should not be accounted for as investment property or as part of the assets of the bank. Such property should be recorded on a memorandum basis.

2.2 The related facility should remain classified in the books of the bank until such property is disposed of and the proceeds realized by the bank.

3. Your attention is drawn to Section 48A of the Banking Act No.30 of 1988, as amended by Act No. 33 of 1995, which requires banks to dispose of property acquired by foreclosure of collateral from defaulting customers or which have devolved on the banks as part settlement of debt, at the earliest opportunity.

Yours faithfully,

*sgd.* Director of Bank Supervision

Department of Bank Supervision  
31 December 2004

To: CEOs of Licensed Commercial Banks  
Secretary General/SLBA

Dear Sirs,

[Withdrawals on Savings Accounts](#)

This is to inform you that the restriction on payment of interest for a particular month, on savings accounts in respect of which there had been more than 4 withdrawals per month, in terms of Circular No. BS/6/81 dated 29 June 1990, has been removed with immediate effect.

Please acknowledge receipt.

Yours faithfully,

*sgd.* **Director of Bank Supervision**

02/04/003/0400/002

Bank Supervision Department

16 December 2004

**To:** CEOs of Licensed Commercial Banks  
CEOs of Licensed Specialised Banks  
Panel of Approved Auditors  
Secretary General/SLBA

Dear Sirs

**Shipping Guarantees Issued by Banks**

Further to the discussion of the above subject at the Meetings of the Chief Executive Officers of Licensed Commercial Banks and Licensed Specialised Banks, the amendment to the Directions on Single Borrower Limit and Risk Weighted Capital Adequacy Ratio to enable the banks to include shipping guarantees issued at the invoice value of goods, are included herewith.

Please acknowledge receipt.

Yours faithfully

sgd. **Director of Bank Supervision**

**Encls:**

**BANKING ACT NO. 30 OF 1988  
AS AMENDED BY BANKING ACT NO. 33 OF 1995**

Amendment to the Determination made by the Monetary Board of the Central Bank of Sri Lanka as amended by the determination made on 29<sup>th</sup> November 2000, under Section 19(2) and 19(7)(a) of the Banking Act No. 30 of 1988 as amended by the Banking (Amendment) Act No. 33 of 1995.

**The following is added to the definition of Shipping Guarantees under Item 19.1 in Schedule I of the above determination with immediate effect:**

The invoice value of goods under each consignment for which the shipping guarantee is issued could be included.

Colombo  
15 December 2004

sgd. Sunil Mendis  
**Governor**

**BANKING ACT NO. 30 OF 1988  
AS AMENDED BY BANKING ACT NO. 33 OF 1995**

Amendment to the Directions issued by the Monetary Board of the Central Bank of Sri Lanka as amended by the Direction dated 29<sup>th</sup> November 2000, under Section 76 J(1) of the Banking Act No. 30 of 1988 as amended by the Banking (Amendment) Act No. 33 of 1995.

**The following is added to the definition of Shipping Guarantees under Item 18.1 in Schedule I of the above determination with immediate effect:**

The invoice value of goods under each consignment for which the shipping guarantee is issued could be included.

Colombo  
15 December 2004

sgd. Sunil Mendis  
**Governor**

**BANKING ACT NO. 30 OF 1988  
AS AMENDED BY BANKING (AMENDMENT) ACT NO. 33 OF 1995**

Amendment to the directions issued under Section 46(1)(c) of the Banking Act No. 30 of 1988 as amended by the Banking (Amendment) Act No. 33 of 1995.

sgd. Sunil Mendis  
Governor

Colombo  
15 December 2004

**BANKING ACT (SINGLE BORROWER LIMIT)  
DIRECTION NO. 2 OF 1999**

The above Direction dated 11 October 1999, as amended on 18 November 2003 is amended by the insertion of the following paragraphs as paragraph 4A and 5A:

4A. For the purpose of computing total advances under paragraph 4(i) above, shipping guarantees issued should be included at the invoice value of goods under each consignment.

5A. For the purpose of computing the outstanding amounts of accommodation under paragraph 3 or paragraph 4 above, shipping guarantees issued could be included at the invoice value of goods under each consignment.

The above amendment will be operative with immediate effect.

**BANKING ACT NO. 30 OF 1988  
AS AMENDED BY BANKING (AMENDMENT) ACT NO. 33 OF 1995**

Amendment to the directions issued under Section 76J(1) of the Banking Act No. 30 of 1988 as amended by the Banking (Amendment) Act No. 33 of 1995.

sgd. Sunil Mendis  
Governor

Colombo  
15 December 2004

**DIRECTIONS UNDER SECTION 76J(1)  
SINGLE BORROWER LIMIT**

The following paragraph shall be inserted as paragraph 3

3. For the purpose of computing accommodation under paragraph 1 above, shipping guarantees issued could be included at the invoice value of goods under consignment.

The above amendment will be operative with immediate effect.

02/04/002/0103/002

Bank Supervision Department  
16 December 2004

To: CEOs of all Licensed Commercial Banks  
Panel of Approved Auditors  
Secretary General/SLBA

Dear Sirs,

**Valuation of Securities for Provisioning Purposes**

Further to the discussion of the above subject at the Meeting of the Chief Executive Officers of Licensed Commercial Banks and Licensed Specialised Banks, and the agreement reached at the meeting held on 25.10.2004, please note the following amendment to the Directions issued in terms of Section 46A of the Banking Act No. 30 of 1988 as amended by the Banking (Amendment) Act No. 33 of 1995, amendment to the Direction dated 15 August 2003, and the Circular dated 13 July 2004.

Please acknowledge receipt.

Yours faithfully

sgd. **Director of Bank Supervision**

**Amendment to Directions on 'Suspension of Interest on Non-performing Advances and Classification of Bad and Doubtful advances for Provisioning Purposes: Valuation of Security for Provisioning Purposes' issued in terms of Section 46A of the Banking Act No. 30 of 1988 as amended by Banking (Amendment) Act No. 33 of 1995**

The following paragraph shall be inserted after Section 1 of Schedule II of the above Direction.

The requirement to obtain a Current Professional Valuation report shall not apply in respect of loans and advances of/with a balance of Rupees One million (Rs. 1,000,000) or below, subject to the availability of a current internal assessment of the value of properties mortgaged for such loans, signed by the Assistant General Manager or such other senior officer of the bank in charge of credit.

A 'current internal assessment' is defined as an assessment of the value of the property by an employee of the bank, that is not more than two years old.

The above amendment will be operative with immediate effect.

Colombo  
15 December, 2004

sgd. Sunil Mendis  
**Governor**

16 July 2004

To : CEOs of Licensed Commercial Banks Incorporated outside Sri Lanka  
Auditors approved by the CBSL  
Secretary General, SLBA  
All Officers

Dear Sir

**Single Borrower Limit**

This has reference to the amendment made to the direction issued with regard to the Single Borrower Limit (SBL) on 24 December 2002, making the SBL applicable also to the Offshore Banking Units. The licensed commercial banks incorporated outside Sri Lanka that consider advances as the basis for the computation of their SBL are required to :-

- (i) Treat the Domestic Banking Unit (DBU) and the Off-shore Banking Unit (OBU) separately and to limit the single borrower exposure in these units to 15% of the accommodation of the respective units;
- (ii) Where a bank wishes to use an SBL of 15% of the consolidated accommodation of the DBU and the OBU, such limit determined in US Dollars could be applied for OBU provided, such excess over 15% of the OBU accommodation be supported by a Head Office guarantee or an undertaking.
- (iii) Where a single customer enjoys facilities from both the DBU and the OBU of the same bank, the combined exposure to such customer should be limited to 15% of the total accommodation of either the DBU or the OBU whichever is higher; and
- (iv) Consider the monthly average of total accommodation of the preceding year as certified by a firm of External Auditors as the basis for the computation of the SBL from year 2005.

If any of the current exposures i.e. as at 30 June 2004 are in excess of the limits referred to above such excesses are required to be regularized to fall within the provisions of this circular by the end of the year 2004.

Yours faithfully

Sgd: **Director of Bank Supervision**

08 September 2004

**To : CEOs of All Licensed Commercial Banks**

Dear Sir

**Classification of Bad & Doubtful Advances for Provisioning Purposes**

We refer to the agreement reached at the Meeting of CEOs of Licensed Commercial Banks (LCBs) and Licensed Specialised Banks (LSBs) held on 19 August 2004, to introduce guidelines on the basis of which deviations could be sought by banks from classification norms stipulated in the Directions dated 22 August 1997 issued by the Central Bank under Section 46 A of the Banking Act, in respect of Project Oriented Term Loans to small and medium enterprises.

The banks are advised to adhere to the following guidelines in this regard.

**Guidelines on which a Deviation may be approved on the Classification of Medium and Long term Project loans :**

- I. **Eligible Advances** : Medium and Long-term project loans. (Loans with a maturity of more than 12 months)
- II. **Deviation Permitted** : A six month period of default may be observed before classification as Non-performing Advances (NPA) instead of the 3 month period of arrears considered under the existing directions. (Permitting a longer period than 6 months would be contrary to the CRIB Act, and also 6 months is considered a sufficient period of time to test a project's capacity to revive from project-related problems).
- III. **Conditions to be satisfied by banks when seeking approval for deviations:**
  - a) The lending bank should provide reasonable grounds to show that the existing problem is a result of circumstances beyond the control of the borrower and not due to his exceeding his borrowing capacity.
  - b) The circumstances should be of a temporary nature and should not affect the long-term viability of the project.

Such circumstances would be :

1. Sudden cancellation of certain/specific orders due to problems faced by the buyer and not due to poor quality of goods/services supplied.
2. Natural calamities such as floods, drought or, in the case of agriculture and fisheries projects, diseases affecting the products that would hamper normal operations. The bank should substantiate the capacity of the

project to recommenced normal operations within an agreed period of time.

3. Developments in the international markets that would adversely affect the conditions of the supplier/buyer.
4. Government legislation that creates temporary impediments in the fields of the respective projects.
5. Civil commotion and other similar incidents that would temporarily suspend the operations of the project.
6. Temporary stoppage of project operations due to prolonged labour unrests.
7. Temporary economic downturn and cyclical trends affecting a particular sector likely to be corrected during the short term.

The banks should write to the Department of Bank Supervision explaining the circumstances with supporting documentary evidence such as financial statements and cash flows etc. together with a proposed plan of action of the borrower to arrest the temporary problems and commenced repayments.

Please acknowledge receipt of this circular.

Yours faithfully

Sgd: **Director of Bank Supervision**

08 September 2004

**To : CEOs of All Licensed Specialised Banks**

Dear Sir

**Classification of Bad & Doubtful Advances for Provisioning Purposes**

We refer to the agreement reached at the Meeting of CEOs of Licensed Commercial Banks (LCBs) and Licensed Specialised Banks (LSBs) held on 19 August 2004, to introduce guidelines on the basis of which deviations could be sought by banks from classification norms stipulated in the Directions dated 21 November 1997 issued by the Central Bank under Section 76J(1) of the Banking Act, in respect of Project Oriented Term Loans to small and medium enterprises.

The banks are advised to adhere to the following guidelines in this regard.

**Guidelines on which a Deviation may be approved on the Classification of Medium and Long term Project loans :**

- I. **Eligible Advances** : Medium and Long-term project loans. (Loans with a maturity of more than 12 months)
- II. **Deviation Permitted** : A six month period of default may be observed before classification as Non-performing Advances (NPA) instead of the 3 month period of arrears considered under the existing directions. (Permitting a longer period than 6 months would be contrary to the CRIB Act, and also 6 months is considered a sufficient period of time to test a project's capacity to revive from project-related problems).
- IV. **Conditions to be satisfied by banks when seeking approval for deviations:**
  - a) The lending bank should provide reasonable grounds to show that the existing problem is a result of circumstances beyond the control of the borrower and not due to his exceeding his borrowing capacity.
  - b) The circumstances should be of a temporary nature and should not affect the long-term viability of the project.

Such circumstances would be :

1. Sudden cancellation of certain/specific orders due to problems faced by the buyer and not due to poor quality of goods/services supplied.
8. Natural calamities such as floods, drought or, in the case of agriculture and fisheries projects, diseases affecting the products that would hamper normal operations. The bank should substantiate the capacity of the

project to recommenced normal operations within an agreed period of time.

9. Developments in the international markets that would adversely affect the conditions of the supplier/buyer.
10. Government legislation that creates temporary impediments in the fields of the respective projects.
11. Civil commotion and other similar incidents that would temporarily suspend the operations of the project.
12. Temporary stoppage of project operations due to prolonged labour unrests.
13. Temporary economic downturn and cyclical trends affecting a particular sector likely to be corrected during the short term.

The banks should write to the Department of Bank Supervision explaining the circumstances with supporting documentary evidence such as financial statements and cash flows etc. together with a proposed plan of action of the borrower to arrest the temporary problems and commenced repayments.

Please acknowledge receipt of this circular.

Yours faithfully

Sgd: **Director of Bank Supervision**

02/04/003/0400/001

Bank Supervision Department

13 July 2004

To : CEOs of all Licensed Commercial Banks

Dear Sirs

**Classification of Advances and Specific Provisions/Criteria for Selection of Valuers Undertaking the Revaluation of Fixed Assets for the Computation of the Capital Adequacy Ratio**

Licensed Commercial Banks (LCBs) are required to note the following :-

1. Current professional valuation reports referred to in the Directions dated 22 August 1997 on Classification of Advances and Specific Provisions issued under Section 46 A of the Banking Act shall mean current professional valuation reports obtained from **external Independent valuers**.
2. For the Purpose of the Directions referred to in 1 above, the banks are exempted from the requirement to obtain professional valuation reports in respect of loans and advances of Rs. 250,000 or below, subject to the condition that a current internal assessment of the value of properties mortgaged for such loans, signed by the Assistant General Manager or such other senior officer of the bank in charge of credit, is available.

Note : Current internal assessment is defined as an assessment that is not more than two years old.

3. Valuers referred to in the circular dated 19 April 1999 issued on "Criteria for Selection of Valuers Undertaking the Revaluation of Fixed Assets for the Computation of the Capital Adequacy Ratio" shall mean external Independent valuers.

Please acknowledge receipt of this circular.

Yours faithfully

Sgd: **Director of Bank Supervision**

02/04/003/0400/001

Bank Supervision Department

13 July 2004

To : CEOs of all Licensed Specialised Banks

Dear Sirs

**Classification of Advances and Specific Provisions/Criteria for Selection of Valuers Undertaking the Revaluation of Fixed Assets for the Computation of the Capital Adequacy Ratio**

Licensed Specialised Banks (LSBs) are required to note the following :-

2. Current professional valuation reports referred to in the Directions dated 21 November 1997 on Classification of Advances and Specific Provisions issued under Section 76J(1) of the Banking Act shall mean current professional valuation reports obtained from **external Independent valuers**.
2. For the Purpose of the Directions referred to in 1 above, the banks are exempted from the requirement to obtain professional valuation reports in respect of loans and advances of Rs. 250,000 or below, subject to the condition that a current internal assessment of the value of properties mortgaged for such loans, signed by the Assistant General Manager or such other senior officer of the bank in charge of credit, is available.

Note : Current internal assessment is defined as an assessment that is not more than two years old.

3. Valuers referred to in the circular dated 19 April 1999 issued on "Criteria for Selection of Valuers Undertaking the Revaluation of Fixed Assets for the Computation of the Capital Adequacy Ratio" shall mean external Independent valuers.

Please acknowledge receipt of this circular.

Yours faithfully

Sgd: **Director of Bank Supervision**

02/04/002/0005/003

Bank Supervision Department

20 May 2004

To : All Licensed Commercial Banks

Dear Sir/Madam

**Monthly Statement of Liquid Assets for the  
Domestic Banking Unit (DBU) and  
Off-shore Banking Unit (OBU)**

Reference the Determination dated 24.12.2002 and Directions dated 21.01.2003 and 08.10.2003 on the above subject.

All licensed commercial banks are required to note that they should maintain Statutory Liquid Assets of an amount not less than 20% of total liabilities, less liabilities to the Central Bank and to the share holders, in respect of the DBU in Rupees and in respect of the OBU in US dollars, for each month commencing May 2004.

Any deficiency in Statutory Liquid Assets in the DBU or in the OBU will be subject to the provisions of Section 21(3) of the Banking Act, No. 30 of 1988 as amended by the Banking (Amendment) Act, No. 33 of 1995, and the penalty involved will be payable in Rupees in the case of the DBU and in US dollars in the case of the OBU.

Please acknowledge receipt of this letter.

Yours faithfully

Sgd: **Director of Bank Supervision**

Bank Supervision Department

27 April 2004

To : All Approved External Auditors

Dear Sir

**Guidelines for External Auditors relating to their statutory duties in terms of Section 39 of the Banking Act No. 30 of 1988 as amended by the Banking Act No. 33 of 1995**

The Central Bank of Sri Lanka as the Supervisory and regulatory authority of banking institutions strives continually to mitigate and manage the attendant risks in the banking sector in Sri Lanka. The CBSL recognizes the important role played by the External Audit firms in this regard and is working towards improving the quality and the integrity of bank audits.

Significant developments and changes have taken place in the global financial architecture since the introduction of the first guidelines to External Auditors by the CBSL. As you are aware, the Sarbanes-Oxley Act of the US has attempted to address some of these issues. Accordingly, the Monetary Board of the Central Bank of Sri Lanka has approved the attached Addendum to the Guidelines issued on 20 May 1998. The CBSL believes that these additional guidelines will address some of these concerns and contribute towards the improvement of bank audits in Sri Lanka.

Since your firm is one the panel of approved auditors of the Central Bank, you are required to ensure that your firm is in compliance with these guidelines, which are operative with immediate effect.

Please acknowledge receipt of this letter.

Yours faithfully

Sgd: **Director of Bank Supervision**

Encl:

**GUIDELINES FOR EXTERNAL AUDITORS RELATING TO THEIR STATUTORY DUTIES IN  
TERMS OF SECTION 39 OF THE BANKING ACT NO. 30 OF 1988  
AS AMENDED BY THE BANKING ACT NO. 33 OF 1995**

**ADDENDUM**

**Non-Audit Services**

1. Qualified External Auditors shall not undertake any consultancy or other non-audit services with a bank contemporaneously with the external audit. The restricted non-audit services are :
  - Book keeping or other services related to the accounting records or financial statements of the audit client;
  - Financial information systems design and implementation;
  - Appraisal or valuation services, fairness opinions, or contribution-in-kind reports;
  - Actuarial services;
  - Internal audit outsourcing services;
  - Management functions, human resources and payroll services;
  - Broker or dealer, investment adviser, or investment banking services; and
  - Legal services and expert services related to the audit.

This restriction also applies to services provided by entities where a partner of an Audit Firm is a Director or has a significant share holding.

**Management Letter**

2. External Audit firms are requested to submit the Management Letter, which is non-statutory report by the Auditor to the management of the Bank, together with the published audited accounts to the Banks they audit, within five months of the end of the financial year. If the auditors are unable to finalize the Management Letter, they should submit an interim report with their major findings within the said period. This will enable the Banks and the Regulator to identify significant and systemically important risks in a timely manner.

02/04/003/0400/001

Bank Supervision Department

19 January, 2004

To : All Chief Executive Officers of LCBs and LSBs

Dear Sirs

**Guidelines on Credit Rating of Banking Institutions**

I refer to the discussions on the above subject at the meetings of the Chief Executive Officers of Licensed Commercial Banks (LCBs) and Licensed Specialised Banks (LSBs) held on 20.11.2003 and 18.12.2003 and the agreement of the Chief Executive Officers to obtain ratings for banks.

All LCBs and LSBs are hereby required to observe the following guidelines in this regard.

1. All LCBs and LSBs (both local and foreign) are hereby required to obtain a Credit Rating on or before 30 June 2004.
2. All ratings should be from an independent rating agency acceptable to the Central Bank of Sri Lanka.
3. Local Branches of foreign banks may disclose their parent bank's rating.
4. With effect from July 2004, all banks are required to disclose their rating in all their advertisements soliciting deposits and other debt instruments. The fact that a bank has not obtained a rating should also be disclosed, if that is the case.
5. Credit Ratings should be updated annually and the rating report should be submitted to the Central Bank of Sri Lanka within one month from the date of the report.

Please acknowledge the receipt of this letter.

Yours faithfully

Sgd: **Director of Bank Supervision**

2 January 2004

**To : All Licensed Commercial Banks**

Dear Sir/Madam

**DETERMINATION ON CAPITAL ADEQUACY RATIO**

I refer to the Determination on Capital Adequacy Ratio dated 22 August 1997 as amended on 27 December 2001 and 24 December 2002 and write to clarify the following requirements relating to maintenance of the Capital Adequacy Ratio (CAR) in terms of the said Determination.

- I. All Licensed Commercial Banks (LCBs) are required at all times to maintain a CAR of 10 per cent at the minimum in relation to its risk weighted assets, with core capital constituting not less than 5 per cent, both on a bank only/solo basis considering the domestic and off-shore banking units, and on a consolidated basis i.e., including the bank and all subsidiaries. In respect of the foreign banks, the consolidation would be only in respect of the subsidiaries in Sri Lanka, if any.
- II. Accordingly, all LCBs are required to submit two returns on the statutory Capital Adequacy Ratio as at the end of each quarter of the year, commencing from the quarter ended 31 December 2003, as follows:
  - (a) Return indicating the CAR on a bank only/solo basis.
  - (b) Return indicating the CAR on a consolidated basis.
- III. All LCBs are also required to submit the above two returns based on the audited data after the completion of the annual audit, in addition to the quarterly returns.

Yours faithfully,

Sgd: **Director of Bank Supervision**

**02/04/002/0005/003**

Bank Supervision Department

6 January 2004

To : *All Licensed Commercial Banks and  
Licensed Specialised Banks*

Dear Sir/Madam

**INTERPRETATION OF CAPITAL FUNDS**

All Domestic Licensed Commercial Banks and Licensed Specialised Banks are hereby informed that the proceeds of redeemable cumulative preference shares would constitute part of Capital Funds of banks for the purpose of Banking Act, and the direction issued thereunder, relating to the basis for the computation of the Single Borrower Limit and Investments in Equity in terms of section 46 and 17A respectively and, section 76J(1) of the Banking Act.

Yours faithfully

Sgd : **Director of Bank Supervision**