# Notes to the Financial Statements

## 1 Reporting Entity

DFCC Bank PLC ("Bank") is a limited liability public company incorporated and domiciled in Sri Lanka.

The Bank was incorporated in 1955 under DFCC Bank Act, No. 35 of 1955 as a limited liability public company and the ordinary shares of the Bank were listed in the Colombo Stock Exchange.

Consequent to the enactment of the DFCC Bank (Repeal and Consequential Provisions) Act, No. 39 of 2014, the DFCC Bank Act, No. 35 of 1955 was repealed and the Bank was incorporated under the Companies Act, No. 07 of 2007 as a public limited company listed in the Colombo Stock Exchange with the name "DFCC Bank PLC" with effect from 6 January 2015.

The Registrar General of Companies on 1 October 2015 issued the Certificate of Amalgamation in terms of Section 244 (1) (a) of the Companies Act, No. 07 of 2007 that DFCC Vardhana Bank PLC (DVB) has been amalgamated with DFCC Bank PLC in accordance with the provisions of Part VIII of the Companies Act, No. 07 of 2007 with DFCC Bank PLC surviving as the amalgamated entity.

DFCC Bank PLC (DFCC) also obtained a commercial banking license from the Monetary Board of the Central Bank of Sri Lanka in terms of the Banking Act, No. 30 of 1988, as amended, and accordingly upon the amalgamation now operates as a licensed commercial bank.

The registered office of the Bank is at 73/5, Galle Road, Colombo 3.

The Bank does not have an identifiable parent of its own. The Bank is the ultimate parent of the Group companies.

The Bank's Group comprises subsidiary companies viz, DFCC Consulting (Pvt) Limited, Lanka Industrial Estates Limited and Synapsys Limited.

A joint venture company, Acuity Partners (Pvt) Limited which is equally owned, by the Bank and Hatton National Bank PLC.

The Bank has one associate company viz, National Asset Management Limited.

Total employee population of the Bank and the Group on 31 December 2017 was 1,770and 1,869 respectively. (31 December 2016 – 1,642 and 1,760 respectively).

A summary of principal activities of DFCC Bank PLC, its subsidiary companies, associate company and joint venture company is as follows:

### DFCC Bank PLC

Range of financial services such as accepting deposits, corporate credit and retail banking, personal financial services, project financing, investment banking, foreign currency operations, trade finance and dealing in Government Securities and Treasury-related products.

### Subsidiaries

#### DFCC Consulting (Pvt) Limited

Technical, financial and other professional consultancy services in Sri Lanka and abroad.

#### Lanka Industrial Estates Limited

Leasing of land and buildings to industrial enterprises.

#### Synapsys Limited

Information technology services and information technology enabled services.

### Associate

#### National Asset Management Limited

Fund management.

### Joint Venture

#### Acuity Partners (Pvt) Limited

Investment banking-related financial services.

There were no significant changes in the nature of the principal activities of the Group during the financial period under review.

## 2 Basis of Preparation

### 2.1 Statement of Compliance

The consolidated financial statements of the Group and the separate financial statements of the Bank, which comprise the statement of financial position, income statement, statement of profit or loss and other comprehensive income, statement of changes in equity, statement of cash flows and notes thereto, have been prepared in accordance with Sri Lanka Accounting Standards (SLFRSs and LKASs) issued by The Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka) and in compliance with the requirements of the Companies Act, No. 07 of 2007 and the Banking Act, No. 30 of 1988 and amendments thereto.

### 2.2 Approval of Financial Statements by Directors

The financial statements are authorised for issue by the Board of Directors on 19 February 2018.

### 2.3 Consolidated and Separate Financial Statements

DFCC Bank PLC as the parent of subsidiaries under its control is required to present only the consolidated financial statements as per Sri Lanka Accounting Standard LKAS 27 – "Consolidated and Separate Financial Statements". In addition to the consolidated financial statements, separate financial statements are also presented as per the Companies Act, No. 07 of 2007 and Banking Act, No. 30 of 1988 and amendments thereto.

### 2.4 Basis of Measurement

The consolidated and separate financial statements of the Bank have been prepared on the historical cost basis except for the following material items in the statement of financial position:

i. Assets held-for-trading are measured at fair value.
ii. Derivative assets and derivative liabilities held for risk management are measured at fair value.
iii. Financial assets available-for-sale are measured at fair value.
iv. The liability/asset for defined benefit pension obligations is recognised as the present value of the defined benefit pension obligation less the net total of the pension assets maintained in DFCC Bank Pension Fund, a trust separate from the Bank.
v. The liability for defined benefit statutory end of service gratuity obligations is as the present value of the defined benefit gratuity obligation.

The Bank has not designated any financial instrument at fair value which is an option under LKAS 39 – "Sri Lanka Accounting Standard – Financial Instruments: Recognition and Measurement", since it does not have any embedded derivative and the Bank considers that currently, there are no significant accounting mismatches due to recognition or measurement inconsistency between financial assets and financial liabilities.

### 2.5 Materiality and Aggregation

Each material class of similar items is presented separately in the financial statements. Items of a dissimilar nature or function are presented separately unless they are immaterial.

### 2.6 Functional and Presentation Currency

The consolidated and separate financial statements of the Bank are presented in Sri Lanka Rupees (LKR) being the, functional and presentation currency, rounded to the nearest thousand and, unless otherwise stated.

### 2.7 Critical Accounting Estimates and Judgements

#### 2.7.1 General

In the preparation of separate financial statements and consolidated financial statements, the Bank makes judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses.

Management discusses with the Board Audit Committee the development, selection and disclosure of critical accounting policies and their application, and assumptions made relating to major estimation uncertainties.

The use of available information and application of judgement are inherent in the formation of estimates; actual results in the future may differ from estimates upon which financial information is prepared.

Estimates and underlying assumptions are reviewed on an ongoing basis. Changes to estimates in a subsequent financial year, if any, are adjusted prospectively.

Management believes that Bank's critical accounting policies where judgement is necessarily applied are those which relate to impairment of loans and advances, financial leases and goodwill, the valuation of financial instruments, deferred tax assets and provisions for liabilities.

Further information about key assumptions concerning the future and other key sources of estimated uncertainty are set out in the notes to the financial statements.

### *2.7.2 Loan Losses*

The assessment of loan loss as set out in Note 30.2 involves considerable judgement and estimation. Judgement is required firstly to determine whether there are indications that a loss may already have been incurred in individually significant loans and secondly to determine the recoverable amount.

### *2.7.3 Pension Liability*

The estimation of this liability determined by an independent, qualified actuary, necessarily involves long-term assumptions on future changes to salaries, future income derived from pension assets, life expectancy of covered employees, etc. Key assumptions are disclosed in Note 48.1.3.8 on page 214.

The pension scheme is closed to new entrants recruited on or after 1 May 2004 and the basic pension and the survivor pension amount is frozen on the date of cessation of tenured employment. These risk mitigation strategies together with annual actuarial valuation and review of key assumptions tend to reduce the probability that the actual results will be significantly different from the estimate.

### *2.7.4 End of Service Gratuity Liability*

The estimation of this liability, which is not externally funded, determined by an independent qualified actuary necessarily involves long-term assumptions on future changes to salaries, resignations prior to the normal retirement age and mortality of covered employees.

Key assumptions are disclosed in Note 48.1.3.8 on page 214.

### *2.7.5 Current Tax*

The estimation of current tax liability includes interpretation of tax law and judgment on the allowance for losses on loans. The estimation process by the Bank includes seeking expert advice where appropriate and the payment of the current tax liability is on self-assessment basis. In the event, an additional assessment is issued, the additional income tax and deferred tax adjustment, will be in the period in which the assessment is issued, if so warranted.

### *2.7.6 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 and can be utilized against such tax losses. 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. Refer Note 42.2 on page 208 for details.

### *2.7.7 Impairment of Tangible and Intangible Assets*

The assessment of impairment of tangible and intangible assets includes the estimation of the value in use of the asset computed at the present value of the best estimates of future cash flows generated by the asset adjusted for associated risks. This estimation has inherent uncertainties. Impairment losses, if any, are charged to income statement immediately.

## *2.8 Changes in Accounting Policies*

There are no changes to the accounting policies of the Group and the Group has consistently applied the accounting policies for all periods presented in these consolidated and separate financial statements.

## *3 Basis of Consolidation*

### *3.1 General*

The Consolidated Financial Statements are the Financial Statements of the Group, prepared by consistent application of consolidation procedures, which include amalgamation of the Financial Statements of the parent and subsidiaries and accounting for the investments in associate company and joint venture company on the basis of reported results and net assets of the investee instead of the direct equity interest.

Thus, the Consolidated Financial Statements present financial information about the Group as a single economic entity distinguishing the equity attributable to the parent (controlling interest) and attributable to minority shareholders with non-controlling interest.

### *3.2 Transactions Eliminated on Consolidation*

Intra-group balances and transactions, including income, expenses, and dividend are eliminated in full.

### 3.3 Financial Statements of Subsidiaries, Associate Company and Joint Venture Company included in the Consolidated Financial Statements

Audited financial statements are used for consolidation of companies which have a similar financial year end, as the Bank and for other a special review is performed.

Financial statements of Lanka Industrial Estates Limited included in the consolidation has financial year ending 31 March.

The financial statements of DFCC Consulting (Pvt) Limited, Acuity Partners (Pvt) Limited, Synapsys Limited and National Asset Management Limited included in the consolidation have financial years ending on 31 December.

### 3.4 Significant Events and Transactions during the period between Date of Financial Statements of the Subsidiaries, Associate Company and Joint Venture Company and the Date of Financial Statements of the Bank

No adjustments to the results of subsidiaries, associate company and joint venture company have been made as there were no significant events or transactions.

### 3.5 Financial Statements used for Computation of Goodwill or Negative Goodwill on Date of Acquisition

This is based on unaudited financial statements proximate to the date of acquisition.

### 3.6 Taxes on the Undistributed Earnings of Subsidiaries, Associate Company and Joint Venture Company

The distribution of the undistributed earnings of the subsidiaries, associate company and joint venture company is remote in the foreseeable future. As such, 10% withholding tax applicable on the distribution has not been treated as a tax expense in the financial statements of the Group.

## 4 Scope of Consolidation

All subsidiaries have been consolidated.

### 4.1 Subsidiary Companies

Subsidiaries' are investees controlled by the Group. The Group "controls" an investee if it is exposed to, or has rights to, variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. The financial statements of subsidiaries are included in the consolidated financial statements from the date on which control commences until the date when control ceases.

Acquisition method of accounting is used when subsidiaries are acquired by the Bank. Cost of acquisition is measured at the fair value of the consideration, including contingent consideration, given at the date of exchange.

Acquisition-related costs are recognised as an amount of the expense in the profit or loss in the period of which they are incurred. The acquirer's identifiable assets, liabilities and contingent liabilities are generally measured at their fair value at the date of acquisition.

Goodwill is measured as the excess of the aggregate consideration transferred, the amount of non-controlling interest and the fair value of banks previously held equity interest if any, over the net of the amount of the identifiable assets acquired and the liabilities assumed.

The amount of non-controlling interest is measured either at fair value or at the non-controlling interest's proportionate share of the acquirer's identifiable net assets.

In a business combination achieved in stages, the previously held equity interest is premeasured at the acquisition date fair value with a resulting gain or loss in the income statement.

Changes in a parent's ownership interest in a subsidiary that do not result in a loss of control are treated as transactions between equity holders and are reported in equity.

Note 33 on page 198 contains the financial information relating to subsidiaries.

### 4.2 Associate Company

Associate company is the enterprise over which the Bank has significant influence that is neither a subsidiary nor an interest in a joint venture. The Bank has only one associate company, National Asset Management Limited. The consolidated financial statements include the Bank's share of the total comprehensive income of the associate company, on an equity accounted basis, from the date that significant influence commences until the date that significant influence ceases.

Note 34 on page 199 contain financial information relating to associate company.

### 4.3 Joint Venture Company

Joint venture company is an incorporated enterprise in which the Bank owns 50% of the voting shares with a contractual arrangement with the other company, who owns the balance 50% of the voting shares, in terms of which both parties have joint control over that enterprise. The results of the joint venture company are consolidated using equity method. Note 35 on page 200 contains the financial information relating to joint venture company.

## 5 Principal Accounting Policies

Accounting policies are the specific principles, bases, conventions, rules and practices applied consistently by the Bank in presenting and preparing the financial statements. Changes in accounting policies are made, only if the Sri Lanka Accounting Standards require such changes or when a change results in providing more relevant information. New policies are formulated as appropriate to new products and services provided by the Bank or new obligations incurred by the Bank.

### 5.1 Revenue and Expense Recognition

Revenue is recognised to the extent that it is probable that the economic benefit will flow to the Group and the revenue can be reliably measured.

#### 5.1.1 Interest Income and Expense

Details of interest income and expenses are given in Note 10 on pages 172 to 173.

#### 5.1.2 Net Fees and Commission

Details of commission income and expenses are given in Note 11 on pages 173 to 174.

#### 5.1.3 Net Gain from Trading

Details of net gain/loss from trading are given in Note 12 on page 174.

#### 5.1.4 Net Gain/(Loss) from Financial Instruments at Fair Value Through Profit or Loss

Details of net gain/(loss) from Financial Instruments at Fair Value Through Profit or Loss are given in Note 13 on page 174.

#### 5.1.5 Net Gain/(Loss) from Financial Investments

Details of net gain/(loss) from financial instruments are given in Note 14 on page 175.

#### 5.1.6 Foreign Exchange Gain/(Loss)

Items included in the financial statements of the Bank are measured in Sri Lankan Rupees denoted as LKR which is the currency of the primary economic environment in which the Bank operates ("the functional currency") as well as the presentation currency.

Transactions in foreign currencies are recorded in the functional currency at the average exchange rate on the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency at the average exchange rate ruling at the reporting date (viz. date of the statement of financial position) and consequently recognised in the "other operating (loss)/income" in the income statement of the Bank. The average exchange rate used is the middle rates quoted by commercial banks for purchase or sale of the relevant foreign currency.

The Bank does not have any non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency.

Foreign exchange income recognised in the income statement is presented as follows, based on the underlying classification:

i. Foreign exchange gain/(loss) which is part of a trading activity comprising profit or loss from the sale and purchase of foreign currencies for spot exchange is included as net gain from trading (Note 12).

ii. Foreign exchange income or loss on derivatives held-for-risk management purposes and mandatory measured at fair value through profit or loss is recognised as net gain/loss from financial instruments at fair value through profit or loss (Note 13).

The Bank does not have any foreign operation that is a subsidiary, associate, joint venture or a branch and therefore, there is no exchange differences recognised in other comprehensive income.

#### 5.1.7 Other Expenses

All other expenses are recognised on an accrual basis.

### 5.2 Other Taxes

#### 5.2.1 Withholding Tax on Dividend Distributed by Subsidiaries, Associate Company and Join Venture Company.

Dividend distributed out of the taxable profit of the subsidiaries, associate company and joint venture company suffers a 10% deduction at source and is not available for set-off against the tax liability of the Bank. Thus the withholding tax deducted at source, is added to the tax expense of the subsidiary companies, the associate company and joint venture company in the Group's financial statements as a consolidation adjustment.

#### 5.2.2 Withholding Tax on Dividends Distributed by the Bank.

Withholding tax that arises from the distribution of dividends by the Bank is recognised at the time the liability to pay the related dividend is recognised .

#### 5.2.3 Economic Services Charge (ESC)

As per provisions of the Economic Services Charge (ESC) Act, No. 13 of 2006 and subsequent amendments thereto, ESC is payable on aggregate turnover of the Bank at 0.5% and is deductible from income tax payable.

#### 5.2.4 Crop Insurance Levy (CIL)

As per the provisions of the Section 14 of the Finance Act, No. 12 of 2013, the CIL was introduced with effect from 01st of April 2013 and is payable to the National Insurance Trust Fund. Currently the CIL is payable at 1% of the profit after tax.

### 5.3 Financial Assets

#### 5.3.1 Recognition and Measurement

The financial asset is measured initially at fair value plus, for an item not at fair value through profit or loss, transaction cost that are directly attributable to its acquisition.

Loans and advances are initially recognised on the date at which they are originated at fair value which is usually the loan amount granted and subsequent measurement is at amortised cost.

The amortised cost of a financial asset is the amount at which the financial asset is measured at initial recognition minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between the initial amount recognised and the maturity amount, minus any reduction for impairment.

All other financial assets are initially recognised on the trade date at which the Bank becomes a party to the contractual provisions of the instrument.

#### 5.3.2 Classification

At the inception, a financial asset is classified and measured at fair value and classified as follows:

- **Loans and receivables** – at amortised cost.
- **Held to maturity** – non-derivative financial assets with fixed or determinable payments and fixed maturity (for example, bonds, debentures and debt instruments listed in the Colombo Stock Exchange) that the Bank has the positive intent and ability to hold to maturity are measured at amortised cost.
- **Fair value through profit or loss** – financial assets held-for-trade measured at fair value with changes in fair value recognised in the income statement.
  - **Designated at fair value** – this is an option to deal with accounting mismatches and currently the Bank has not exercised this option.
  - **Derivative assets** – are mandatorily measured at fair value with fair value changes recognised in the income statement.
- **Available for sale** – this is measured at fair value and is the residual classification with fair value changes recognised in other comprehensive income.

#### 5.3.3 Reclassification

- Non-derivative financial assets (other than those designated at fair value through profit or loss upon initial recognition) may be reclassified out of the fair value through profit or loss category, in the following circumstances:
- Financial assets that would have met the definition of loans and receivables at initial recognition (if the financial asset had not been required to be classified as held for trading) may be reclassified out of the fair value through profit or loss category if there is the intention and ability to hold the financial asset for the foreseeable future or until maturity; and
- Financial assets except financial assets that would have met the definition of loans and receivables at initial recognition may be reclassified out of the fair value through profit or loss category and into another category in rare circumstances.

### 5.3.4 Derecognition of Financial Assets

Financial assets are derecognised when the contractual right to receive cash flows from the asset has expired; or when Bank has transferred its contractual right to receive the cash flows of the financial assets, and either –

- Substantially all the risks and rewards of ownership have been transferred;
  or
- Bank has neither retained nor transferred substantially all the risks and rewards, but has not retained control of the financial asset.

### 5.3.5 Fair Value Measurement

"Fair value" is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or, in its absence, the most advantageous market to which the Bank has access at that date. The fair value of a liability reflects its non-performance risk.

When available, the Bank measures the fair value of an instrument using the quoted price in an active market for that instrument. A market is regarded as active, if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

If there is no quoted price in an active market, then the Bank uses valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The chosen valuation technique incorporates all of the factors that market participants would take into account in pricing a transaction.

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price – i.e., the fair value of the consideration given or received. If the Bank determines that the fair value at initial recognition differs from the transaction price and the fair value is evidenced neither by a quoted price in an active market for an identical asset or liability nor based on a valuation technique that uses only data from observable markets, then the financial instrument is initially measured at fair value, adjusted to defer the difference between the fair value at initial recognition and the transaction price.

Subsequently, that difference is recognised in profit or loss on an appropriate basis over the life of the instrument but no later than when the valuation is wholly supported by observable market data or the transaction is closed out.

If an asset or a liability measured at fair value has a bid price and an ask price, then the Bank measures assets and long positions at a bid price and liabilities and short positions at an ask price.

Portfolios of financial assets and financial liabilities that are exposed to market risk and credit risk that are managed by the Bank on the basis of the net exposure to either market or credit risk are measured on the basis of a price that would be received to sell a net long position (or paid to transfer a net short position) for a particular risk exposure. Those portfolio-level adjustments are allocated to the individual assets and liabilities on the basis of the relative risk adjustment of each of the individual instruments in the portfolio.

The fair value of a demand deposit is not less than the amount payable on demand, discounted from the first date on which the amount could be required to be paid.

The Bank recognises transfers between levels of the fair value hierarchy as end of the reporting period during which the change has occurred.

### 5.3.6 Identification and Measurement of Impairment

At each reporting date, the Bank assesses whether there is an objective evidence that financial assets not carried at fair value through profit or loss are impaired. A financial asset or a group of financial assets is impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset(s) that can be estimated reliably.

#### 5.3.6.1 Loans and Advances and Held-to-Maturity Investment Securities

Objective evidence that loans and advances and held-to-maturity investment securities (e.g., debt instruments quoted in the Colombo Stock Exchange, Treasury Bills and Bonds) are impaired can include significant financial difficulty of the borrower or issuer, default or delinquency by a borrower, restructuring of a loan or advance by the Bank on terms that the Bank would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the Group or economic conditions that correlate with defaults in the Group.

The Bank considers evidence of impairment for loans and advances and held-to-maturity investment securities at both a specific and collective level. Details of the individual and collective assessment of impairments are given in Note 16 on pages 176 and 177.

#### *5.3.6.2 Available-for-Sale Financial Assets*

At each date of statement of financial position an assessment is made of whether there is any objective evidence of impairment in the value of a financial asset. Impairment losses are recognised if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the financial asset (a "loss event") and that loss event (or events) have an impact on the estimated future cash flows of the financial asset that can be reliably estimated.

If the available-for-sale financial asset is impaired, the difference between the financial asset's acquisition cost (net of any principal repayments and amortisation) and the current fair value, less any previous impairment loss recognised in the income statement, is removed from other comprehensive income and recognised in the income statement.

#### *5.3.6.3 Available-for-Sale Debt Securities*

When assessing available-for-sale debt securities for objective evidence of impairment at the reporting date. Bank considers all available evidence, including observable data or information about events specifically relating to the securities which may result in a shortfall in recovery of future cash flows. These events may include a significant financial difficulty of the issuer, a breach of contract such as a default, bankruptcy or other financial recognition, or the disappearance of an active market for the debt security.

These types of specific events and other factors such as information about the issuers' liquidity, business and financial risk exposures, levels of and trends in default for similar financial assets, national and local economic trends and conditions, and the fair value of collateral and guarantees may be considered individually, or in combination, to determine if there is objective evidence of impairment of a debt security.

#### *5.3.6.4 Available-for-Sale Equity Securities*

Objective evidence of impairment for available-for-sale equity securities may include specific information about the issuer and information about significant changes in technology, markets, economics or the law that provide evidence that the cost of the equity securities may not be recovered.

A significant or prolonged decline in the fair value of the asset below its cost is also objective evidence of impairment. In assessing whether it is significant, the decline in fair value is evaluated against the original cost of the asset at initial recognition. In assessing whether it is prolonged, the decline is evaluated against the period in which the fair value of the asset has been below its original cost at initial recognition.

Once an impairment loss has been recognised on an available-for-sale financial asset, the subsequent accounting treatment for changes in the fair value of that asset differs depending on the nature of the available-for-sale financial asset concerned:

- For an available-for-sale debt security, a subsequent decline in the fair value of the instrument is recognised in the income statement when there is further objective evidence of impairment as a result of further decreases in the estimated future cash flows of the financial asset. Where there is no further objective evidence of impairment, a decline in the fair value of the financial asset is recognised in other comprehensive income. If the fair value of a debt security increases in a subsequent period, and the increase can be objectively related to an event occurring after the impairment loss was recognised in the income statement, the impairment loss is reversed through the income statement. If there is no longer objective evidence that the debt security is impaired, the impairment loss is also reversed through the income statement.
- For an available-for-sale equity security, all subsequent increases in the fair value of the instrument are treated as a revaluation and are recognised in other comprehensive income. Impairment losses on the equity security are not reversed through the income statement. Subsequent decreases in the fair value of the available-for-sale equity security are in the income statement, to the extent that further cumulative impairment losses have been incurred in relation to the acquisition cost of the equity security.

#### 5.3.6.5 Impairment of Intangible Assets – Computer Application Software and Goodwill on Consolidation

The Bank reviews on the date of the statement of financial position, whether the carrying amount is lower than the recoverable amount. In such event, the carrying amount is reduced to the recoverable amount and the reduction being an impairment loss is immediately recognised in the income statement. The recoverable amount is the value in use.

### 5.3.7 Offsetting

Financial assets and financial liabilities are offset and the net amount is reported in the statement of financial position when there is a legally enforceable right to offset the amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously. Income and expenses are presented on a net basis only when permitted under SLAS or for gains and losses arising from a group of similar transactions.

### 5.3.8 Fiduciary Assets

Assets held in a fiduciary capacity are not reported in these financial statements as they do not belong to the Bank.

## 5.4 Financial Liabilities

### 5.4.1 Recognition and Initial Measurement

Deposits, borrowing from foreign multilateral, bilateral sources and domestic sources, debt securities issued and subordinated liabilities are initially recognised on the date at which they are originated. A financial liability is measured initially at fair value plus, transaction costs that are directly attributable to its acquisition or issue.

Subsequent measurement of financial liability is at fair value or amortised cost. The amortised cost of a financial liability is the amount at which the financial liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between the initial amount and the maturity amount.

### 5.4.2 Derecognition of Financial Liabilities

Group derecognises a financial liability when its contractual obligations are discharged, cancelled or expired.

### 5.4.3 Due to Banks, Customers, Debt Securities Issued and Other Borrowing

Financial liabilities are recognised when Group enters into the contractual provisions of the arrangements with counterparties, which is generally on trade date, and initially measured at fair value, which is normally the consideration received, net of directly attributable transaction costs incurred. Subsequent measurement of financial liabilities is at amortised cost, using the effective interest method to amortise the difference between proceeds received, net of directly attributable transaction costs incurred, and the redemption amount over the expected life of the instrument.

### 5.4.4 Provisions

Provisions are recognised when it is probable that an outflow of economic benefits will be required to settle a current legal or constructive obligation, which has arisen as a result of past events, and for which a reliable estimate can be made of the amount of the obligation.

### 5.4.5 Sale and Repurchase Agreements

When securities are sold subject to a commitment to repurchase them at a predetermined price ("repos"), they remain on the statement of financial position and a liability is recorded in respect of the consideration received.

Securities purchased under commitments to sell ("reverse repos") are not recognised on the statement of financial position and the consideration paid is recorded in "loans and advances to banks", "loans and advances to customers" as appropriate. The difference between the sale and repurchase price is treated as interest and recognised over the life of the agreement for loans and advances to banks and customers.

## 5.5 Stated Capital

Shares are classified as equity when there is no contractual obligation to transfer cash or other financial assets.

## 6 Cash Flow

The cash flow has been prepared by using the "Direct Method". Cash and cash equivalents include cash balances, time deposits and Treasury Bills of three months maturity at the time of issue. For the purpose of cash flow statement, cash and cash equivalents are presented net of bank overdrafts.

## 7 Directors' Responsibility

The Directors acknowledge the responsibility for true and fair presentation of the financial statements in accordance with Sri Lanka Accounting Standards.

## 8 New SLFRS Issued and Not Yet Effective

### 8.1 SLFRS Applicable for Financial Periods beginning on or after 1 January 2018

#### 8.1.1 SLFRS 9 – "Financial Instruments"

SLFRS 9, issued in 2014, replaces the existing guidance in LKAS 39 – "Financial Instruments: Recognition and Measurement" is effective for annual reporting periods beginning on or after 1 January 2018. The key aspects of SLFRS 9 are:

1. Classification – Financial assets

   SLFRS 9 contains a new classification and measurement approach for financial assets that reflects the business model in which assets are managed and their cash flow characteristics.

   SLFRS 9 includes three principal classification categories for financial assets – i.e. measured at amortised cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL). It eliminates the existing LKAS 39 categories of held-to-maturity, loans and receivables and available for sale.

2. Impairment – Financial assets, loan commitment and financial guarantee contracts

   SLFRS 9 replaces the 'Incurred Loss Model in LKAS 39 with forward looking "Expected Loss Model '(ECL). This will require considerable judgement over how changes in economic factors affect ECL, which will be determined in a probability weighted basis.

   SLFRS 9 requires loan loss to be recognised at an amount equal to either 12 month ECL or life time ECL. Lifetime ECLs are the ECLs that result from possible default events over the expected life of a financial instrument, whereas 12 months ECLs are the portion of the ECLs that results from default events that are possible within 12 months after the reporting date.

3. Inputs into measurement of ECLs

   The key inputs into measurement of ECLs are likely to be the term structures of the following variables which will be derived from internally developed statistical models and other historical data that leverage regulatory models. They will be adjusted to reflect forward looking information.

   - Probability of Default (PD) are estimates at a certain date which will be calculated based on statistical models and assessed using rating tools tailored to the various categories of counterparties and exposures
   - Loss Given Default (LGD) is the magnitude to the likely loss if there is default. The Bank estimates LGD parameters based on history of recovery rates of claims against defaulted counter parties
   - Exposure at Default (EAD) represents the expected exposure in the event of a default. The Bank will derive the EAD from the current exposure to the counter party and potential chances to the current amount allowed under the contract.

The most significant impact on the Bank's Financial Statements from the implementation of SLFRS 9 is expected to result from the new impairment requirements. Impairment losses will increase and become more volatile for financial instruments within the scope of SLFRS 9.

The Bank has employed statistical models to analyse the data collected and generate estimates of the remaining lifetime PD of exposure and how these are expected to change as a result of the passage of time. This analysis include the identification and calibration of relationship between changes in default rates and changes in key macroeconomic factors as well as analysis of the impact of certain other factors on the risk of default.

The Bank has estimated LGD parameters based on the history of recovery rates of claims against defaulted counterparties. The LGD models consider the structure, collateral, seniority of the claim, counterparty industry and recovery costs of any collateral that is integral to the financial asset.

EAD for lending commitments and financial guarantees, include the amount drawn, as well as potential future amounts that may be drawn or repaid under the contract, which has been estimated based on historical observations and forward looking forecasts.

Under SLFRS 9, the Bank has incorporated forward looking information into both its assessment of whether the credit risk of an instrument has increased significantly since its initial recognition and its measurement of ECL.

The Bank has completed the initial high level assessment of the potential impact on its Financial Statements for the year ended 31 December 2016, resulting from the application of SLFRS 9 with the assistance of an external consultant.

Based on the preliminary assessments undertaken to date which is yet to be audited, the total estimated additional loan loss provision on the financial statements for the year ended 31 December 2016 on adoption of SLFRS 9 is expected to be in the range of 35% to 40%. It will also have an impact on capital adequacy ratio by 99 to 115 basis points on Tier 1 due to the reduction in the retained earnings.

The above assessment which is yet to be audited is preliminary because not all transition work has been finalised. The actual impact of adopting SLFRS 9 on 1 January 2018 may change because:

- SLFRS 9 will require the Bank to revise accounting process and internal controls and these changes are not yet complete;
- The Bank is refining and finalising its models for ECL calculations; and
- The new accounting policies, assumptions, judgements and estimation techniques employed are subject to change until the Bank finalises its first Financial Statements for the year 31 December 2018 that include the date of initial application.

The Bank is in the process of assessing the additional loan loss provision impact on the Financial Statements for the year ended 31 December 2017, resulting from the application of SLFRS 9.

The Group does not expect significant impact on the Consolidated Financial Statements resulting from the application of SLFRS 9 on the other group entities.

### *8.1.2 SLFRS 15 – "Revenue from Contracts with Customers"*

SLFRS 15 establishes a comprehensive framework for determining whether, how much and when revenue is recognised . New qualitative and quantitative disclosure requirements aim to enable financial statements users to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers.

Entities will apply five step model to determine when to recognise revenue and at what amount. The model specified that revenue is recognised when or as an entity transfers control of goods and services to a customer at the amount to which the entity expects to be entitled. Depending on whether certain criteria are met, revenue is recognised .

It replaces existing revenue recognition guidance, including LKAS 18 – "Revenue" and LKAS 11 – "Construction Contracts" and IFRIC 13 – "Customer Loyalty Programmes". SLFRS 15 is effective for annual reporting periods beginning on or after 1 January 2018, with early adoption permitted.

The Group/Bank does not expect significant impact on its financial statements resulting from the application of SLFRS 15.

### *8.1.3 SLFRS 16 – "Leases"*

SLFRS 16 eliminates the current dual accounting model for lessees which distinguishes between On-Balance Sheet finance leases and Off-Balance Sheet operating leases.

Instead, there will be a single On-Balance Sheet accounting model that is similar to current finance lease accounting.

SLFRS 16 is effective for annual reporting periods beginning on or after 01 January 2019. The Group/Bank is assessing the potential impact on its financial statements resulting from the application of SLFRS 16.

## 9 Income

### *Accounting Policy →*

*Revenue is recognised to the extent that it is probable that the economic benefit will flow to the Group and the revenue can be reliably measured.*

| For the year ended 31 December | BANK | | GROUP | |
|---|---|---|---|---|
| | **2017 LKR 000** | 2016 LKR 000 | **2017 LKR 000** | 2016 LKR 000 |
| Interest income (Note 10) | **32,986,590** | 24,194,158 | **32,994,636** | 24,206,112 |
| Fee and commission income (Note 11) | **1,591,336** | 1,309,049 | **1,591,943** | 1,309,049 |
| Net gain from trading (Note 12) | **361,647** | 340,456 | **361,647** | 340,456 |
| Net loss from financial instruments at fair value through profit or loss (Note 13) | **(404,586)** | (179,727) | **(404,586)** | (179,727) |
| Net gain from financial investments (Note 14) | **2,238,166** | 1,165,389 | **1,945,118** | 1,081,129 |
| Other operating (loss)/income – net (Note 15) | **(831,541)** | (75,430) | **(501,667)** | 223,064 |
| | **35,941,612** | 26,753,895 | **35,987,091** | 26,980,083 |

## 10 Net Interest Income

### *Accounting Policy →*

*Interest income and expense for all interest-bearing financial instruments are recognised in "Interest Income" and "Interest Expense" in the income statement, using the effective interest rate of the financial assets or financial liabilities to which they relate.*

*The effective interest rate is the rate that exactly discounts estimated future cash receipts or payments earned or paid on a financial asset or financial liability through its expected life (or, where appropriate, a shorter period) to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, bank estimates future cash flows considering all contractual terms of the financial instruments but not future credit losses.*

*The calculation of the effective interest includes all transaction cost, premiums or discounts and fees paid or received by the Bank that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or liability.*

*Interest income includes income from finance leases, dividend from preference shares and notional tax credit on interest income from Treasury Bills and Bonds.*

*Finance lease income is recognised on a pattern reflecting a constant periodic rate of return on the Bank's net investment in the finance lease.*

| For the year ended 31 December | BANK | | GROUP | |
|---|---|---|---|---|
| | **2017 LKR 000** | 2016 LKR 000 | **2017 LKR 000** | 2016 LKR 000 |
| **Interest income** | | | | |
| Placements with banks | **123,369** | 203,105 | **131,415** | 215,059 |
| Loans to and receivables from banks | **928,176** | 531,828 | **928,176** | 531,828 |
| Loans to and receivables from other customers | **26,789,982** | 20,559,370 | **26,789,982** | 20,559,370 |
| Other financial assets held for trading | **41,523** | 154,544 | **41,523** | 154,544 |
| Financial investments – available for sale | **2,433,596** | 1,587,178 | **2,433,596** | 1,587,178 |
| Financial investments – held to maturity | **2,669,944** | 1,158,133 | **2,669,944** | 1,158,133 |
| Total interest income | **32,986,590** | 24,194,158 | **32,994,636** | 24,206,112 |
| **Interest expenses** | | | | |
| Due to banks | **979,281** | 1,293,423 | **979,281** | 1,293,423 |
| Due to other customers | **15,293,031** | 9,552,556 | **15,246,422** | 9,522,440 |
| Other borrowing | **1,645,138** | 1,366,328 | **1,645,138** | 1,366,328 |
| Debt securities issued | **3,726,532** | 3,080,715 | **3,726,532** | 3,080,715 |
| Total interest expenses | **21,643,982** | 15,293,022 | **21,597,373** | 15,262,906 |
| **Net interest income** | **11,342,608** | 8,901,136 | **11,397,263** | 8,943,206 |
| **Interest income on Sri Lanka Government Securities** | **5,032,032** | 2,485,194 | **5,032,032** | 2,485,194 |

This income includes notional tax credit of 10% imputed for the withholding tax deducted/paid at source.

## 11 Net Fee and Commission Income

### *Accounting Policy →*

*Fee and commission income and expense that are integral to the effective interest rate on a financial asset or liability are included in the measurement of the effective interest rate.*

*Other fees and commission income are recognised as the related services are performed. When a loan commitment is not expected to result in the draw-down of a loan, the related loan commitment fees are recognised on a straight-line basis over the commitment period.*

*Fees for guarantees and trade related commissions are recognised on a straight line basis over the period of the contract. Other fees and commission expense relate mainly to transaction and service fees, which are expensed, as the services are received.*

| For the year ended 31 December | BANK | | GROUP | |
|---|---|---|---|---|
| | **2017 LKR 000** | 2016 LKR 000 | **2017 LKR 000** | 2016 LKR 000 |
| Fee and commission income | **1,591,336** | 1,309,049 | **1,591,943** | 1,309,049 |
| Fee and commission expenses | – | – | – | – |
| **Net fee and commission income** | **1,591,336** | 1,309,049 | **1,591,943** | 1,309,049 |
| Comprising: | | | | |
| Loans and advances | **553,094** | 403,589 | **553,094** | 403,589 |
| Credit cards | **4,932** | 4,820 | **4,932** | 4,820 |
| Trade and remittances | **429,528** | 390,020 | **429,528** | 390,020 |
| Customer accounts | **342,984** | 281,056 | **342,984** | 281,056 |
| Guarantees | **206,798** | 161,805 | **206,798** | 161,805 |
| Management and consulting and other fees | **54,000** | 67,759 | **54,607** | 67,759 |
| **Net fee and commission income** | **1,591,336** | 1,309,049 | **1,591,943** | 1,309,049 |

## 12 Net Gain from Trading

This comprises all gains less losses from changes in fair value of financial assets held for trading (both realised and unrealised) together with related dividend and foreign exchange differences.

| For the year ended 31 December | BANK | | GROUP | |
|---|---|---|---|---|
| | **2017 LKR 000** | 2016 LKR 000 | **2017 LKR 000** | 2016 LKR 000 |
| Foreign exchange from banks | **270,395** | 176,346 | **270,395** | 176,346 |
| Fixed income | **67,536** | 164,110 | **67,536** | 164,110 |
| Equities | **23,716** | – | **23,716** | – |
| | **361,647** | 340,456 | **361,647** | 340,456 |

## 13 Net loss from financial instruments at fair value through profit or loss

### *Accounting Policy →*

*Bank has not chosen the option to designate financial instruments at fair value through profit or loss as a compensatory mechanism for accounting mismatches that would otherwise arise from measuring assets or liabilities or recognising gains or losses on them on different bases.*

*The Bank has non-trading derivatives held for risk management purposes (e.g., forward foreign exchange purchase or sale contracts) that do not form part of qualifying hedge relationship, that are mandatorily fair valued through profit or loss. In respect of such financial instruments, all realised and unrealised fair value changes and foreign exchange differences are included.*

| For the year ended 31 December | BANK | | GROUP | |
|---|---|---|---|---|
| | **2017 LKR 000** | 2016 LKR 000 | **2017 LKR 000** | 2016 LKR 000 |
| Forward exchange fair value changes | | | | |
| Contracts with commercial banks | **(314,489)** | (93,944) | **(314,489)** | (93,944) |
| Contract with CBSL (Note 41.1) | **(86,277)** | (83,606) | **(86,277)** | (83,606) |
| Interest rate swap fair value changes | **(3,820)** | (2,177) | **(3,820)** | (2,177) |
| | **(404,586)** | (179,727) | **(404,586)** | (179,727) |

## 14 Net Gain from Financial Investments

### Accounting Policy →

*Dividend income is recognised when the right to receive payment is established. Dividend income are presented in net gains/(loss) from trading and net gains/(loss) from financial investment, based on underlying classification of the equity investment.*

*Net gain/loss from financial investments includes realised gain or loss on sale of available-for-sale securities (e.g., Treasury Bills and Bonds, ordinary shares – both listed in the Colombo Stock Exchange and unlisted) and dividend income from ordinary shares classified as available for sale. Where the dividend clearly represents a recovery of part of the cost of the investment, it is presented in other comprehensive income.*

| | BANK | | GROUP | |
|---|---|---|---|---|
| *For the year ended 31 December* | **2017 LKR 000** | 2016 LKR 000 | **2017 LKR 000** | 2016 LKR 000 |
| Assets available for sale | | | | |
| Gain on sale of equity securities | **1,150,368** | 152,186 | **948,783** | 152,186 |
| Gain on sale of Government Securities | **1,559** | 4,202 | **1,559** | 4,202 |
| Dividend income | **798,420** | 772,046 | **798,420** | 772,046 |
| Dividend income from subsidiaries, joint venture and associate | **91,463** | 84,260 | – | – |
| Net gain from repurchase transactions | **196,356** | 152,695 | **196,356** | 152,695 |
| | **2,238,166** | 1,165,389 | **1,945,118** | 1,081,129 |

## 15 Other operating income/(loss) – net

### Accounting Policy →

*Rental income and expenses are accounted on a straight-line basis over the entire period of the tenancy incorporating predetermined rent escalation during the period of the tenancy.*

| | BANK | | GROUP | |
|---|---|---|---|---|
| *For the year ended 31 December* | **2017 LKR 000** | 2016 LKR 000 | **2017 LKR 000** | 2016 LKR 000 |
| Premises rental income | **39,383** | 37,815 | **262,021** | 228,951 |
| Gain on sale of property, plant and equipment | **11,299** | 7,694 | **11,299** | 13,631 |
| Foreign exchange loss | **(849,494)** | (330,157) | **(849,494)** | (330,154) |
| Recovery of loans written off | **36,769** | 24,499 | **36,769** | 24,499 |
| Amortisation of deferred income on Government Grant – CBSL Swap (Note 41.2) | **(85,973)** | 180,106 | **(85,973)** | 180,106 |
| Others | **16,475** | 4,613 | **123,711** | 106,031 |
| | **(831,541)** | (75,430) | **(501,667)** | 223,064 |

## 16 Impairment for Loans and Other Losses

### Accounting Policy →

#### Individually Assessed Loans and Advances and Held-to-Maturity Debt Instruments

*These are exposures, where evidence of impairment exists and that are individually significant meriting individual assessment for objective evidence of impairment and computation of impairment allowance. The factors considered in determining that the exposures are individually significant include*

- *the size of the loan; and*
- *the number of loans in the portfolio.*

*For all loans and held-to-maturity debt instruments that are considered individually significant, Bank assesses on a case by case basis, whether there is any objective evidence of impairment. The criteria used by the Bank to determine that there is such objective evident include*

- *contractual payments for either principal or interest being past due for a prolonged period;*
- *the probability that the borrower will enter bankruptcy or other financial realisation;*
- *a concession granted to the borrower for economic or legal reasons relating to the borrower's financial difficulty that results in forgiveness or postponement of principal, interest or fees, where the concession is not insignificant; and*
- *there has been deterioration in the financial condition or outlook of the borrower such that its ability to repay is considered doubtful.*

*For those loans and held-to-maturity investment securities where objective evidence of impairment exists, impairment losses are determined considering the following factors:*

- *Bank's aggregate exposure to the customer;*
- *The viability of the customer's business model and their capacity to trade successfully out of financial difficulties and generate sufficient cash flow to service debt obligations;*
- *the amount and timing of expected receipts and recoveries;*
- *the likely dividend available on liquidation or bankruptcy;*
- *the extent of other creditors' commitments ranking ahead of or pari passu with, the Bank and*
- *the likelihood of other creditors continuity to support the Company;*
- *the realisable value of security (or other credit mitigants) and likelihood of successful repossession or enforcement of security;*
- *the likely deduction of any costs involved in recovery of amounts outstanding.*

*Impairment allowance on loans and advances and held-to-maturity investment securities measured at amortised cost are calculated as the difference between the carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate.*

#### Collective Assessment, this includes:

*All loans and advances of smaller value where there is no evidence of impairment and those individually assessed for which no evidence of impairment has been specifically identified on an individual basis.*

- *Import loans*
- *Export loans*
- *Corporate term loans*
- *Overdraft*
- *Personal loans*
- *Finance leases*
- *Project Loans*
- *Credit Cards*

*These loans and advances are grouped together according to their credit risk characteristics for the purpose of calculating an estimated collective impairment.*

*In assessing collective impairment, the Bank uses statistical modelling of historical trends of the default rates, the timing of recoveries and the amount of loss incurred, adjusted for experience adjustment by the management, where current economic and credit conditions are such that the actual losses are likely to be greater or less than suggested by historical trends.*

*Default rates, loss rates and the expected timing of future recoveries will be regularly benchmarked against actual outcomes to ensure that they remain appropriate.*

*Individually assessed loans for which, no evidence of impairment 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 impairment. This reflects impairment losses that Bank has incurred as a result of events occurring before the reporting date which the Bank is not able to identify on an individual 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 and held-to-maturity investment securities within the Group, these are removed from the Group and assessed on an individual basis for impairment. The collective impairment allowance is based on historical loss experience adjusted by Management's experienced judgement.*

*Impairment allowance on loans and advances and held-to-maturity investment securities measured at mortised cost are calculated as the difference between the carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate.*

#### Reversals of Impairment

*If the amount of an impairment loss decreases in a subsequent period, and the decrease can be related objectively to an event occurring after the impairment was recognised, the excess is written back by reducing the loan impairment allowance accordingly. The write back is recognised in the income statement.*

#### Renegotiated Loans

*Loans subject to collective impairment assessment whose terms have been renegotiated are no longer considered past due, but are treated as up-to-date loans for measurement purposes once a minimum number of payments required have been received.*

*Loans subject to individual impairment assessment, whose terms have been renegotiated, are subject to ongoing review to determine whether they remain impaired. The carrying amounts of loans that have been classified as renegotiated retain this classification until maturity or derecognition.*

#### Write-off of Loans and Advances

*Loans (and the related impairment allowance) are normally written off, either partially or in full, when there is no realistic prospect of recovery. Where loans are secured, this is generally after receipt of any proceeds from the realisation of security. In circumstances where the net realisable value of any collateral has been determined and there is no reasonable expectation of further recovery, write-off may be earlier.*

#### Asset-Backed Securities

*These are included in loans and advances. When assessing for objective evidence of impairment, Bank considers the performance of underlying collateral.*

| | BANK | | GROUP | |
|---|---|---|---|---|
| *For the year ended 31 December* | **2017 LKR 000** | 2016 LKR 000 | **2017 LKR 000** | 2016 LKR 000 |
| Loans to and receivables from other customers | | | | |
| Specific allowance for impairment (Note 30.2.1) | **724,402** | 792,389 | **724,402** | 792,389 |
| Collective allowance for impairment (Note 30.2.2) | **405,973** | 81,772 | **405,973** | 81,772 |
| Impairment charge/(recoveries) – other debts | **17,748** | 5,371 | **21,597** | 5,371 |
| Impairment charge – investment in other equity securities | **12,915** | 33,929 | **12,915** | 33,929 |
| Impairment charge – investment in subsidiaries (Note 33.1) | **9,896** | 20,923 | – | – |
| Write-offs – loans to and receivables from other customers | **5,479** | 2,883 | **5,479** | 2,883 |
| | **1,176,413** | 937,267 | **1,170,366** | 916,344 |

## 17 Personnel Expenses

### Accounting Policy →

#### Employee Benefits

##### Defined Benefit Plans (DBPs)

*A Defined Benefit Plan is a post-employment benefit plan other than a Defined Contribution Plan as defined in the Sri Lanka Accounting Standard – LKAS 19 on "Employee Benefits".*

#### Pension Liability Arising from Defined Benefit Obligations

##### Description of the Plan and Employee Groups Covered

*The Bank established a trust fund in May 1989, for payment of pension which operates the pension scheme approved by the Commissioner General of Inland Revenue. The fund of the scheme is managed by trustees appointed by the Bank and is separate from the Bank. The scheme provides for payment of pension to retirees, spouse and minor children of deceased retirees based on pre-retirement salary. All members of the permanent staff who joined prior to 1 May 2004 are covered by this funded pension scheme subject to fulfilment of eligibility conditions prescribed by the Bank.*

*The scheme was amended on 31 August 1998 and the amended plan will apply to all members of the permanent staff who joined the Bank on or after this date and prior to 1 May 2004. The amendment reduced the scope of the benefit in the interest of long-term sustainability of the pension plan as advised by the independent actuary.*

*The defined benefit pension plan does not permit any post-retirement increases in pension nor any other benefit (e.g. medical expenses reimbursement).*

### Funding Arrangement

*The Bank's contributions to the trust fund are made annually based on the recommendation of an independent actuary. The employees make no contributions to qualify for the basic pension, which is therefore a non-contributory benefit to the employees.*

*Eligible employees who desire to provide for the payment of pension to spouse and minor children, who survive them are however, required to contribute monthly, an amount based on a percentage of gross emoluments, excluding bonus, if they joined the Bank on or after 31 August 1998 and prior to 1 May 2004.*

### Recognition of Actuarial Gains and Losses

*The net actuarial gains or losses arising in a financial year is due to increases or decreases in either the present value of the promised pension benefit obligation or the fair value of pension assets.*

*The causes for such gains or losses include changes in the discount rate, differences between the actual return and the expected return on pension assets and changes in the estimates of actual employee turnover, mortality rates and increases in salary.*

*The Bank recognises the total actuarial gains and losses that arise in calculating the Bank's obligation in respect of the plan in other comprehensive income and the expense under personnel expenses in the income statement during the period in which it occurs.*

### Recognition of Past Service Cost

*Past service cost arises when a defined benefit plan is introduced for the first time or subsequent changes are made to the benefits payable under an existing defined benefit plan. Bank will recognise past service cost as an expense on a straight-line basis over the average period until the benefits become vested. To the extent the benefits are already vested following the introduction of or changes to a defined benefit plan, the Bank will recognise past service cost immediately.*

## Provision for End of Service Gratuity Liability under a Defined Benefit Plan

### Description of the Plan and Employee Groups Covered

*The Bank provides for the gratuity payable under the Payment of Gratuity Act, No. 12 of 1983 as amended for all employees who do not qualify under the pension scheme. Therefore, this applies to employees recruited to the permanent cadre on or after 1 May 2004 on tenured or fixed term contract employment in the Bank. The subsidiary companies, which do not have a non-contributory pension scheme provide for the gratuity payable under the Payment of Gratuity Act, No. 12 of 1983 for all employees. The promised benefit is half a month pre-termination salary for each completed year of service, provided a minimum qualifying period of 5 years is served prior to termination of employment.*

*The Bank however, recognises the liability by way of a provision for all employees in tenured employment from the date they joined the permanent cadre, while fixed term employees liability is recognised only if the fixed term contract of service provides for unbroken service of 5 years or more either singly or together with consecutive contracts.*

### Funding Arrangement

*The Bank and the subsidiaries adopt a pay-as-you-go method whereby the employer makes a lump sum payment only on termination of employment by resignation, retirement at the age of 55 years or death while in service.*

### Recognition of Actuarial Gains and Losses

*The Bank recognises the total actuarial gains and losses in the other comprehensive income during the period in which it occurs.*

### Recognition of Past Service Cost

*Since end of service gratuity defined benefit is a statutory benefit, the recognition of past service cost will arise only if the Payment of Gratuity Act, No. 12 of 1983 is amended in future to increase the promised benefit on termination of employment. In such event, the Bank will adopt the accounting policy currently used for defined benefit pension plan.*

### Defined Contribution Plans

*This provides for a lump sum payment on termination of employment by resignation, retirement at the age of 55 years or death while in service.*

*Lump sum payment is by an outside agency to which contributions are made.*

*All employees of the Bank are members of the Mercantile Service Provident Society and the Employees' Trust Fund to which the Bank contributes 15% and 3% respectively of such employee's consolidated salary.*

*Contributions to defined contribution plans are recognised as an expense in the income statement as incurred.*

| For the year ended 31 December | BANK | | GROUP | |
|---|---|---|---|---|
| | **2017 LKR 000** | 2016 LKR 000 | **2017 LKR 000** | 2016 LKR 000 |
| Salaries and other benefits | **2,770,383** | 2,429,063 | **2,880,514** | 2,574,073 |
| Provision for staff retirement benefits (Note 17.1) | **396,126** | 380,679 | **422,279** | 405,996 |
| | **3,166,509** | 2,809,742 | **3,302,793** | 2,980,069 |

## 17.1 Provision for Staff Retirement Benefits

### 17.1.1 Amount Recognised as Expense

#### 17.1.1.1 Funded Pension Liability

| | BANK 2017 | BANK 2016 | GROUP 2017 | GROUP 2016 |
|---|---|---|---|---|
| Current service cost | **60,496** | 71,746 | **60,496** | 71,746 |
| Interest on obligation | **228,094** | 206,681 | **228,094** | 206,681 |
| Expected return on pension assets | **(233,917)** | (193,785) | **(233,917)** | (193,785) |
| | **54,673** | 84,642 | **54,673** | 84,642 |

#### 17.1.1.2 Unfunded Pension Liability

| | BANK 2017 | BANK 2016 | GROUP 2017 | GROUP 2016 |
|---|---|---|---|---|
| Interest on obligation | **5,794** | 5,688 | **5,794** | 5,688 |
| | **5,794** | 5,688 | **5,794** | 5,688 |

#### 17.1.1.3 Unfunded End of Service Gratuity Liability

| | BANK 2017 | BANK 2016 | GROUP 2017 | GROUP 2016 |
|---|---|---|---|---|
| Current service cost | **35,041** | 29,417 | **41,507** | 33,853 |
| Interest on obligation | **22,096** | 17,440 | **23,877** | 19,218 |
| | **57,137** | 46,857 | **65,384** | 53,071 |
| **Total defined benefit plans** | **117,604** | 137,187 | **125,851** | 143,401 |

#### 17.1.1.4 Defined Contribution Plan

| | BANK 2017 | BANK 2016 | GROUP 2017 | GROUP 2016 |
|---|---|---|---|---|
| Employer's contribution to employees' provident fund | **232,102** | 202,910 | **245,952** | 218,284 |
| Employer's contribution to employees' trust fund | **46,420** | 40,582 | **50,476** | 44,311 |
| **Total defined contribution plans** | **278,522** | 243,492 | **296,428** | 262,595 |
| **Total expense recognised in the income statement** | **396,126** | 380,679 | **422,279** | 405,996 |

## 18 Other Expenses

| For the period ended | BANK 2017 LKR 000 | BANK 2016 LKR 000 | GROUP 2017 LKR 000 | GROUP 2016 LKR 000 |
|---|---|---|---|---|
| Directors' remuneration | **17,241** | 18,582 | **18,117** | 19,472 |
| Auditors' remuneration | | | | |
| Audit fees and expenses | **5,207** | 3,900 | **5,975** | 4,623 |
| Audit related fees and expenses | **1,706** | 1,265 | **1,889** | 1,316 |
| Fees for non-audit services | **4,750** | 1,150 | **4,750** | 1,150 |
| Depreciation – investment property | – | – | **13,718** | 13,800 |
| – property, plant and equipment | **259,548** | 233,079 | **286,424** | 257,532 |
| Amortisation – intangible assets | **109,573** | 98,262 | **110,807** | 98,567 |
| Expenses on litigation | **4,728** | 2,767 | **4,728** | 2,767 |
| Premises, equipment and establishment expenses | **1,285,640** | 1,049,987 | **1,309,156** | 1,048,935 |
| Other overhead expenses | **1,015,253** | 905,232 | **995,866** | 873,475 |
| | **2,703,646** | 2,314,224 | **2,751,430** | 2,321,637 |

Directors' remuneration include fees paid to Non-Executive Directors. Remuneration paid to Executive Directors are included under salaries and other benefits in Note 17.

## 19 Value Added Tax and Nation Building Tax on Financial Services

### Value Added Tax on Financial Services (VAT)

**Accounting Policy →**

*VAT on financial services is calculated in accordance with Value Added Tax Act, No. 14 of 2002 and subsequent amendments thereto.*

*The value base for computation of VAT is the operating profit before value added tax and nation building tax on financial services adjusted for emoluments of employees and depreciation computed as per prescribed rates.*

**Nation Building Tax on Financial Services (NBT)**

*NBT on financial services is calculated in accordance with Nation Building Tax Act, No. 09 of 2009 and subsequent amendments thereto. NBT is chargeable on the same base used for calculation of VAT on financial services.*

| For the period ended | | BANK 2017 LKR 000 | BANK 2016 LKR 000 | GROUP 2017 LKR 000 | GROUP 2016 LKR 000 |
|---|---|---|---|---|---|
| **19.1 Value Added Tax on Financial Services** | | | | | |
| Financial services VAT | – Current year | **1,286,661** | 854,680 | **1,286,661** | 854,680 |
| | – (Over)/under provision in respect of previous year | – | 2,495 | – | 2,495 |
| | | **1,286,661** | 857,175 | **1,286,661** | 857,175 |

| For the period ended | BANK | | GROUP | |
|---|---|---|---|---|
| | **2017 LKR 000** | 2016 LKR 000 | **2017 LKR 000** | 2016 LKR 000 |

### 19.2 Nation Building Tax on Financial Services

| | | | | |
|---|---|---|---|---|
| Nation building tax on | | | | |
| Financial services – Current year | **171,554** | 137,105 | **171,554** | 137,105 |
| – Over provision in respect of previous year | **534** | (8,170) | **534** | (8,170) |
| | **172,088** | 128,935 | **172,088** | 128,935 |
| | **1,458,749** | 986,110 | **1,458,749** | 986,110 |

## 20 Income Tax Expense

### Accounting Policy →

*Income Tax expense comprises current and deferred tax. Current tax and deferred tax are recognised in the income statement except to the extent that they relate to items recognized directly in equity and other comprehensive income.*

#### Current Taxation

*Current tax is the amount of income tax payable on the taxable profit for the financial year calculated using tax rates enacted or substantially enacted at the reporting date, and any adjustment to tax payable in respect of previous years. Taxable profit is determined in accordance with the provisions of Inland Revenue Act, No 10 of 2006 as amended.*

#### Deferred Taxation

*Deferred tax is recognised on temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.*

*Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that future taxable profits will be available against which deductible temporary differences can be utilised.*

*Deferred tax is calculated using the tax rates expected to apply in the periods in which the assets will be realised or the liabilities settled. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets.*

#### Withholding Tax on Dividend Distributed by Subsidiaries, Associate Company and Joint Venture Company

*Dividend distributed out of the taxable profit of the subsidiaries, associate company and joint venture company suffers a 10% deduction at source and is not available for set off against the tax liability of the Bank. Thus the withholding tax deducted at source is added to the tax expense of the subsidiary companies, the associate company and joint venture company in the Group financial statements as a consolidation adjustment.*

| For the year ended 31 December | BANK | | GROUP | |
|---|---|---|---|---|
| | **2017 LKR 000** | 2016 LKR 000 | **2017 LKR 000** | 2016 LKR 000 |

### 20.1 Composition

| | | | | |
|---|---|---|---|---|
| Current tax | **1,321,584** | 1,027,194 | **1,388,734** | 1,084,646 |
| (Over)/Under provision in previous years | **(20,655)** | 57,912 | **(20,627)** | 57,827 |
| Deferred tax – Origination and reversal of temporary differences (Note 42) | **76,420** | 39,701 | **89,546** | 62,621 |
| | **1,377,349** | 1,124,807 | **1,457,653** | 1,205,094 |

### 20.1.1 Reconciliation of Effective Tax Rate with Income Tax Rate

| For the year ended 31 December | BANK | | | | GROUP | | | |
|---|---|---|---|---|---|---|---|---|
| | 2017 | | 2016 | | 2017 | | 2016 | |
| | % | LKR 000 | % | LKR 000 | % | LKR 000 | % | LKR 000 |
| Tax using 28% tax rate on profit before tax (PBT) | **28.00** | **1,621,847** | 28.00 | 1,235,788 | **28.00** | **1,648,943** | 28.00 | 1,308,767 |
| Non-deductible expenses | **15.25** | **883,444** | 16.64 | 734,605 | **15.13** | **890,726** | 15.94 | 745,177 |
| Allowable deductions | **(5.01)** | **(290,324)** | (7.79) | (343,916) | **(4.97)** | **(292,919)** | (7.54) | (352,204) |
| Dividend income | **(3.66)** | **(212,156)** | (5.24) | (231,478) | **(3.60)** | **(212,156)** | (4.95) | (231,478) |
| Tax incentives | **(10.26)** | **(594,350)** | (7.36) | (324,683) | **(10.16)** | **(598,048)** | (6.95) | (324,973) |
| Taxable timing difference from capital allowances on assets | **(1.50)** | **(86,877)** | 0.64 | 28,148 | **(1.48)** | **(86,939)** | 0.60 | 28,143 |
| Tax losses from prior year | **–** | **–** | (1.61) | (71,270) | **(0.01)** | **(470)** | (1.53) | (71,651) |
| Adjustments | **–** | **–** | – | – | **0.67** | **39,597** | (0.37) | (17,135) |
| Current tax expense | **22.82** | **1,321,584** | 23.28 | 1,027,194 | **23.58** | **1,388,734** | 23.20 | 1,084,646 |

## 21 Basic Earnings per Ordinary Share

Basic earnings per share of the Bank has been calculated by dividing the profit after income tax by the weighted average number of shares in issue during the financial year.

Basic group earnings per share has been calculated by dividing the profit after income tax attributable to the equity holders of the Bank by the weighted average number of shares in issue during the financial year.

| Year ended 31 December | BANK | | GROUP | |
|---|---|---|---|---|
| | 2017 LKR 000 | 2016 LKR 000 | 2017 LKR 000 | 2016 LKR 000 |
| Profit attributable to equity holders of the Bank (LKR '000) | **4,414,964** | 3,288,723 | **4,362,407** | 3,414,980 |
| Number of ordinary shares (Note 50) | **265,097,688** | 265,097,688 | **265,097,688** | 265,097,688 |
| Basic earnings per ordinary share – LKR | **16.65** | 12.41 | **16.46** | 12.88 |

## 22 Dividend per Share

Dividend per share (LKR)

The Board of Directors of the Bank has approved the payment of a first and final dividend of LKR 5.00 per share for the year ended 31 December 2017.

## 23 Analysis of Financial Instruments by Measurement Basis

| As at 31 December 2017 | Fair value through profit or loss – mandatory LKR 000 | Fair value held for trading LKR 000 | Fair value through other comprehensive income LKR 000 | Amortised cost LKR 000 | Held to maturity LKR 000 | Total LKR 000 |
|---|---|---|---|---|---|---|
| **23.1 Bank** | | | | | | |
| **Financial Assets** | | | | | | |
| Cash and cash equivalents | – | – | – | 4,106,225 | – | 4,106,225 |
| Balances with Central Bank of Sri Lanka | – | – | – | 10,557,688 | – | 10,557,688 |
| Placements with banks | – | – | – | 6,691,381 | – | 6,691,381 |
| Derivative assets held-for-risk management | 66,440 | – | – | – | – | 66,440 |
| Other financial assets held for trading | – | 310,922 | – | – | – | 310,922 |
| Loans to and receivables from banks | – | – | – | 10,984,266 | – | 10,984,266 |
| Loans to and receivables from other customers | – | – | – | 213,675,866 | – | 213,675,866 |
| Financial investments | – | – | 56,866,054 | – | 23,507,632 | 80,373,686 |
| Due from subsidiaries | – | – | – | 12,083 | – | 12,083 |
| Government grant receivable | 642,583 | – | – | – | – | 642,583 |
| Other assets | – | – | – | 2,775,741 | – | 2,775,741 |
| | 709,023 | 310,922 | 56,866,054 | 248,803,250 | 23,507,632 | 330,196,881 |
| **Financial Liabilities** | | | | | | |
| Due to banks | – | – | – | 9,640,735 | – | 9,640,735 |
| Derivative liabilities held-for-risk management | 367,435 | – | – | – | – | 367,435 |
| Due to other customers | – | – | – | 193,307,534 | – | 193,307,534 |
| Other borrowing | – | – | – | 41,319,591 | – | 41,319,591 |
| Debt securities issued | – | – | – | 24,443,767 | – | 24,443,767 |
| Subordinated term debt | – | – | – | 9,202,870 | – | 9,202,870 |
| Other liabilities | – | – | – | 4,078,984 | – | 4,078,984 |
| | 367,435 | – | – | 281,993,481 | – | 282,360,916 |

## 23.2 Bank

| As at 31 December 2016 | Fair value through profit or loss – mandatory LKR 000 | Fair value held for trading LKR 000 | Fair value through other comprehensive income LKR 000 | Amortised cost LKR 000 | Held to maturity LKR 000 | Total LKR 000 |
|---|---|---|---|---|---|---|
| **Financial Assets** | | | | | | |
| Cash and cash equivalents | – | – | – | 4,330,934 | – | 4,330,934 |
| Balances with Central Bank of Sri Lanka | – | – | – | 8,062,567 | – | 8,062,567 |
| Placements with banks | – | – | – | 1,351,117 | – | 1,351,117 |
| Derivative assets held-for-risk management | 122,977 | – | – | – | – | 122,977 |
| Loans to and receivables from banks | – | – | – | 12,300,398 | – | 12,300,398 |
| Loans to and receivables from other customers | – | – | – | 185,784,979 | – | 185,784,979 |
| Financial investments | – | – | 49,272,243 | – | 23,189,085 | 72,461,328 |
| Due from subsidiaries | | – | – | 19,855 | – | 19,855 |
| Government grant receivable | 861,915 | – | – | – | – | 861,915 |
| Other assets | – | – | – | 2,562,978 | – | 2,562,978 |
| | 984,892 | | 49,272,243 | 214,412,828 | 23,189,085 | 287,859,048 |
| **Financial Liabilities** | | | | | | |
| Due to banks | – | – | – | 18,103,587 | | 18,103,587 |
| Derivative liabilities held-for-risk management | 105,741 | – | – | – | | 105,741 |
| Due to other customers | – | – | – | 140,514,373 | | 140,514,373 |
| Other borrowing | – | – | – | 40,751,346 | | 40,751,346 |
| Debt securities issued | – | – | – | 29,179,185 | | 29,179,185 |
| Subordinated term debt | – | – | – | 9,205,637 | | 9,205,637 |
| Other liabilities | – | – | – | 3,850,825 | | 3,850,825 |
| | 105,741 | – | – | 241,604,953 | – | 241,710,694 |

| As at 31 December 2017 | Fair value through profit or loss – mandatory LKR 000 | Fair value held for trading LKR 000 | Fair value through other comprehensive income LKR 000 | Amortised cost LKR 000 | Held to maturity LKR 000 | Total LKR 000 |
|---|---|---|---|---|---|---|
| **23.3 Group** | | | | | | |
| **Financial Assets** | | | | | | |
| Cash and cash equivalents | – | – | – | 4,120,230 | – | 4,120,230 |
| Balances with Central Bank of Sri Lanka | – | – | – | 10,557,688 | – | 10,557,688 |
| Placements with banks | – | – | – | 6,712,131 | – | 6,712,131 |
| Derivative assets held-for-risk management | 66,440 | – | – | – | – | 66,440 |
| Other financial assets held for trading | – | 310,922 | – | – | – | 310,922 |
| Loans to and receivables from banks | – | – | – | 10,984,266 | – | 10,984,266 |
| Loans to and receivables from other customers | – | – | – | 213,675,866 | – | 213,675,866 |
| Financial investments | – | – | 56,866,054 | – | 23,507,632 | 80,373,686 |
| Government grant receivable | 642,583 | – | – | – | – | 642,583 |
| Other assets | – | – | – | 2,804,798 | – | 2,804,798 |
| | 709,023 | 310,922 | 56,866,054 | 248,854,979 | 23,507,632 | 330,248,610 |
| **Financial Liabilities** | | | | | | |
| Due to banks | – | – | – | 9,640,735 | – | 9,640,735 |
| Derivative liabilities held-for-risk management | 367,435 | – | – | – | – | 367,435 |
| Due to other customers | – | – | – | 192,920,147 | – | 192,920,147 |
| Other borrowing | – | – | – | 41,290,874 | – | 41,290,874 |
| Debt securities issued | – | – | – | 24,443,767 | – | 24,443,767 |
| Subordinated term debt | – | – | – | 9,202,870 | – | 9,202,870 |
| Other liabilities | – | – | – | 4,195,940 | – | 4,195,940 |
| | 367,435 | – | – | 281,694,333 | – | 282,061,768 |

| As at 31 December 2016 | Fair value through profit or loss – mandatory LKR 000 | Fair value held for trading LKR 000 | Fair value through other comprehensive income LKR 000 | Amortised cost LKR 000 | Held to maturity LKR 000 | Total LKR 000 |
|---|---|---|---|---|---|---|
| ***23.4 Group*** | | | | | | |
| **Financial Assets** | | | | | | |
| Cash and cash equivalents | – | – | – | 4,344,260 | – | 4,344,260 |
| Balances with Central Bank of Sri Lanka | – | – | – | 8,062,567 | – | 8,062,567 |
| Placements with banks | – | – | | 1,415,985 | | 1,415,985 |
| Derivative assets held-for-risk management | 122,977 | – | | – | | 122,977 |
| Loans to and receivables from banks | – | – | | 12,300,398 | | 12,300,398 |
| Loans to and receivables from other customers | – | – | – | 185,784,979 | | 185,784,979 |
| Financial investments | – | – | 49,272,243 | – | 23,189,085 | 72,461,328 |
| Government grant receivable | 861,915 | – | – | – | – | 861,915 |
| Other assets | – | – | – | 2,609,655 | – | 2,609,655 |
| | 984,892 | – | 49,272,243 | 214,517,844 | 23,189,085 | 287,964,064 |
| **Financial Liabilities** | | | | | | |
| Due to banks | – | – | – | 18,103,587 | – | 18,103,587 |
| Derivative liabilities held-for-risk management | 105,741 | | | – | – | 105,741 |
| Due to other customers | – | | | 140,219,872 | | 140,219,872 |
| Other borrowing | – | | | 40,736,300 | | 40,736,300 |
| Debt securities issued | – | | | 29,179,185 | | 29,179,185 |
| Subordinated term debt | – | | | 9,205,637 | | 9,205,637 |
| Other liabilities | – | | | 3,961,249 | | 3,961,249 |
| | 105,741 | | | 241,405,830 | | 241,511,571 |

## 24 Cash and Cash Equivalents

### *Accounting Policy →*

*For the purpose of the statement of cash flows, cash and cash equivalents include highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value. Such investments are normally those with three months or less than three months' maturity from the date of acquisition.*

*Cash and cash equivalents include cash and short-term Treasury Bills with maximum three months' maturity from date of acquisition.*

*Cash and cash equivalents are carried at amortised cost in the statement of financial position.*

| As at | BANK 31.12.2017 LKR 000 | BANK 31.12.2016 LKR 000 | GROUP 31.12.2017 LKR 000 | GROUP 31.12.2016 LKR 000 |
|---|---|---|---|---|
| Cash in hand | **3,603,883** | 3,193,720 | **3,617,888** | 3,193,825 |
| Balances with banks | **502,342** | 1,137,214 | **502,342** | 1,150,435 |
| | **4,106,225** | 4,330,934 | **4,120,230** | 4,344,260 |

## 25 Balances with Central Bank of Sri Lanka

### Accounting Policy →

*Balances with Central Banks are carried at amortised cost in the statement of financial position.*

| As at | BANK 31.12.2017 LKR 000 | BANK 31.12.2016 LKR 000 | GROUP 31.12.2017 LKR 000 | GROUP 31.12.2016 LKR 000 |
|---|---|---|---|---|
| Statutory balances with Central Bank of Sri Lanka | **10,557,688** | 8,062,567 | **10,557,688** | 8,062,567 |

As required by the provisions of Section 93 of Monetary Law Act, a minimum cash balance is maintained with the Central Bank of Sri Lanka. The minimum cash reserve requirement on rupee deposit liabilities is prescribed as a percentage of rupee deposit liabilities. The percentage is varied from time to time. Applicable minimum rate was 7.5%. There are no reserve requirement for deposit liabilities of the Foreign Currency Banking Unit and foreign currency deposit liabilities in the Domestic Banking Unit.

## 26 Placements with Banks

| As at | BANK 31.12.2017 LKR 000 | BANK 31.12.2016 LKR 000 | GROUP 31.12.2017 LKR 000 | GROUP 31.12.2016 LKR 000 |
|---|---|---|---|---|
| Placements with Banks | **6,691,381** | 1,351,117 | **6,712,131** | 1,415,985 |

## 27 Derivatives Held-for-Risk Management

### Accounting Policy →

*Derivative assets held-for-risk management purposes include all derivative assets that are not classified as trading assets and are measured at fair value in the statement of financial position.*

*Bank has not designated any derivative held-for-risk management purposes as a qualifying hedge relationship and therefore the Bank has not adopted hedge accounting.*

*Derivatives are classified as assets, when their fair value is positive or as liabilities, when their fair value is negative. Derivative assets and liabilities arising from different transactions are only offset, if the transactions are with the same counterparty, a legal right of offset exists, and the parties intend to settle the cash flows on a net basis.*

### 27.1 Assets

| As at | BANK 31.12.2017 LKR 000 | BANK 31.12.2016 LKR 000 | GROUP 31.12.2017 LKR 000 | GROUP 31.12.2016 LKR 000 |
|---|---|---|---|---|
| Forward foreign exchange contracts – Currency Swaps | **65,552** | 104,902 | **65,552** | 104,902 |
| – Other | **888** | 18,075 | **888** | 18,075 |
| | **66,440** | 122,977 | **66,440** | 122,977 |

### 27.2 Liabilities

| As at | BANK 31.12.2017 LKR 000 | BANK 31.12.2016 LKR 000 | GROUP 31.12.2017 LKR 000 | GROUP 31.12.2016 LKR 000 |
|---|---|---|---|---|
| Forward foreign exchange contracts – Currency Swaps | **355,580** | 94,327 | **355,580** | 94,327 |
| – Interest Rate Swaps | **6,028** | 2,177 | **6,028** | 2,177 |
| – Other | **5,827** | 9,237 | **5,827** | 9,237 |
| | **367,435** | 105,741 | **367,435** | 105,741 |

## 28 Other Financial Assets Held for Trading

### Accounting Policy →

*Financial assets are classified as Held-for-trading if;*

- *they are acquired principally for the purpose of selling or repurchasing in the near term; or*
- *they hold as a part of a portfolio that is managed together for short-term profit or position taking; or*

*Financial assets Held-for-trading are recorded in the Statement of Financial Position at fair value. Changes in fair value are recognised in profit or loss. Interest and dividend income are recorded in 'Interest Income' and 'Net Gains/(Losses) from Trading' respectively in the Income Statement, according to the terms of the contract, or when the right to receive the payment has been established.*

| As at | BANK 31.12.2017 LKR 000 | BANK 31.12.2016 LKR 000 | GROUP 31.12.2017 LKR 000 | GROUP 31.12.2016 LKR 000 |
|---|---|---|---|---|
| Government of Sri Lanka Treasury bonds | **279,094** | – | **279,094** | – |
| Equity securities | | | | |
| Quoted (Note 28.1) | **31,828** | – | **31,828** | – |
| | **310,922** | – | **310,922** | – |

### 28.1 Quoted Ordinary Shares – Bank/Group

| As at | 31.12.2017 Number of ordinary shares | 31.12.2017 Cost LKR 000 | 31.12.2017 Fair value LKR 000 | 31.12.2016 Number of ordinary shares | 31.12.2016 Cost LKR 000 | 31.12.2016 Fair value LKR 000 |
|---|---|---|---|---|---|---|
| Commercial Bank of Ceylon PLC – voting | **234,032** | **26,586** | **31,828** | – | – | – |
| | | **26,586** | **31,828** | | – | – |

## 29 Loans to and Receivables from Banks

### *Accounting Policy →*

*Loans and receivables from Bank include amount due from Banks.*

*The carrying amount includes interest receivable from the Banks on these loans. This also includes investment by the Bank in any debentures, bonds, commercial paper or any other debt instrument which is not listed in the Colombo Stock Exchange or in any recognised market. The amount includes the principal amount and interest due and/or accrued on the date of the statement of financial position.*

*Principal amount of loans and advances (for example, over drawn balances in current account) are recognised when cash is advanced to a borrower. They are derecognised when either the borrower repays its obligations, or the loans are written off, or substantially all the risks and rewards of ownership are transferred. They are initially recorded at fair value plus any directly attributable transaction costs and are subsequently measured at amortised cost using the effective interest method, less any reduction for impairment or uncollectibility.*

| | BANK | | GROUP | |
|---|---|---|---|---|
| *As at* | **31.12.2017 LKR 000** | 31.12.2016 LKR 000 | **31.12.2017 LKR 000** | 31.12.2016 LKR 000 |
| Gross loans and receivables | **10,984,266** | 12,300,398 | **10,984,266** | 12,300,398 |
| Allowance for impairment | – | – | – | – |
| **Net loans and receivables** | **10,984,266** | 12,300,398 | **10,984,266** | 12,300,398 |

### 29.1 Analysis

#### 29.1.1 By Product

| | BANK 31.12.2017 | BANK 31.12.2016 | GROUP 31.12.2017 | GROUP 31.12.2016 |
|---|---|---|---|---|
| Refinanced Loans – Plantation development project | **27,977** | 84,148 | **27,977** | 84,148 |
| KFW* DFCC (V) SME in the North and East | – | 2,940 | – | 2,940 |
| Sri Lanka development bonds | **10,956,289** | 12,213,310 | **10,956,289** | 12,213,310 |
| **Gross loans and receivables** | **10,984,266** | 12,300,398 | **10,984,266** | 12,300,398 |

** KFW – Kreditanstalt Fur Wiederaufbau*

#### 29.1.2 By Currency

| | BANK 31.12.2017 | BANK 31.12.2016 | GROUP 31.12.2017 | GROUP 31.12.2016 |
|---|---|---|---|---|
| Sri Lankan Rupee | **27,977** | 87,088 | **27,977** | 87,088 |
| United States Dollar | **10,956,289** | 12,213,310 | **10,956,289** | 12,213,310 |
| **Gross loans and receivables** | **10,984,266** | 12,300,398 | **10,984,266** | 12,300,398 |

## 30 Loans to and Receivables from Other Customers

### *Accounting Policy →*

*Loans to and receivables from other customers include loans and advances and lease receivables of the Group.*

*The carrying amount includes capital and interest receivable from the customers on these loans. This also includes investment by the Bank in any debentures, bonds, commercial paper or any other debt instrument which is not listed in the Colombo Stock Exchange or in any recognised market. The amount includes the principal amount and interest due and/or accrued on the date of the statement of financial position.*

*Principal amount of loans and advances (for example, over drawn balances in current account) are recognised when cash is advanced to a borrower. They are derecognised when either the borrower repays its obligations, or the loans are written off, or substantially all the risks and rewards of ownership are transferred. They are initially recorded at fair value plus any directly attributable transaction costs and are subsequently measured at amortised cost using the effective interest method, less any reduction for impairment or uncollectibility.*

*When the Bank is the lessor in a lease agreement that transfers substantially all of the risk and rewards incidental to the ownership of the asset to the lessee, the arrangement is classified as a finance lease and a receivable equal to the net investment in the lease is recognised and presented within loans and advances.*

| | BANK | | GROUP | |
|---|---|---|---|---|
| *As at* | **31.12.2017 LKR 000** | 31.12.2016 LKR 000 | **31.12.2017 LKR 000** | 31.12.2016 LKR 000 |
| Gross loans and receivables | **221,309,571** | 192,454,529 | **221,309,571** | 192,454,529 |
| Specific allowance for impairment (Note 30.2.1) | **(5,388,754)** | (4,778,752) | **(5,388,754)** | (4,778,752) |
| Collective allowance for impairment (Note 30.2.2) | **(2,244,951)** | (1,890,798) | **(2,244,951)** | (1,890,798) |
| **Net loans and receivables** | **213,675,866** | 185,784,979 | **213,675,866** | 185,784,979 |

### 30.1 Analysis

#### 30.1.1 By Product

| | BANK 31.12.2017 LKR 000 | BANK 31.12.2016 LKR 000 | GROUP 31.12.2017 LKR 000 | GROUP 31.12.2016 LKR 000 |
|---|---|---|---|---|
| Overdrafts | **40,204,544** | 29,115,220 | **40,204,544** | 29,115,220 |
| Trade finance | **29,778,452** | 24,726,990 | **29,778,452** | 24,726,990 |
| Lease rentals receivable (Note 30.1.1.1) | **16,493,374** | 15,909,152 | **16,493,374** | 15,909,152 |
| Credit cards | **276,432** | 242,091 | **276,432** | 242,091 |
| Pawning | **2,597,441** | 2,109,667 | **2,597,441** | 2,109,667 |
| Staff loans | **1,544,400** | 1,397,579 | **1,544,400** | 1,397,579 |
| Term loans | **129,086,941** | 116,395,228 | **129,086,941** | 116,395,228 |
| Commercial papers and asset back notes | **1,140,487** | 962,763 | **1,140,487** | 962,763 |
| Debenture loans | **–** | 71,119 | **–** | 71,119 |
| Preference shares unquoted | **187,500** | 517,500 | **187,500** | 517,500 |
| Securities purchased under resale agreements | **–** | 1,007,220 | **–** | 1,007,220 |
| **Gross loans and receivables** | **221,309,571** | 192,454,529 | **221,309,571** | 192,454,529 |

| As at | BANK 31.12.2017 LKR 000 | BANK 31.12.2016 LKR 000 | GROUP 31.12.2017 LKR 000 | GROUP 31.12.2016 LKR 000 |
|---|---|---|---|---|

### 30.1.1.1 Lease rentals receivable

| | | | | |
|---|---|---|---|---|
| Gross investment in leases: | | | | |
| Lease rentals receivable | | | | |
| – within one year | **8,167,382** | 7,260,287 | **8,167,382** | 7,260,287 |
| – one to five years | **11,774,307** | 11,667,471 | **11,774,307** | 11,667,471 |
| | **19,941,689** | 18,927,758 | **19,941,689** | 18,927,758 |
| Less: Deposit of rentals | **12,551** | 11,480 | **12,551** | 11,480 |
| Unearned income on rentals receivable | | | | |
| – within one year | **1,720,165** | 1,483,826 | **1,720,165** | 1,483,826 |
| – one to five years | **1,715,599** | 1,523,300 | **1,715,599** | 1,523,300 |
| | **16,493,374** | 15,909,152 | **16,493,374** | 15,909,152 |

### 30.1.2 By Currency

| | | | | |
|---|---|---|---|---|
| Sri Lankan Rupee | **199,579,777** | 175,840,682 | **199,579,777** | 175,840,682 |
| United States Dollar | **20,885,187** | 16,021,231 | **20,885,187** | 16,021,231 |
| Great Britain Pound | **511,472** | 428,982 | **511,472** | 428,982 |
| Australian Dollar | **16,099** | 18,140 | **16,099** | 18,140 |
| Euro | **317,036** | 145,494 | **317,036** | 145,494 |
| **Gross loans and receivables** | **221,309,571** | 192,454,529 | **221,309,571** | 192,454,529 |

### 30.1.3 By Industry

| | | | | |
|---|---|---|---|---|
| Agriculture and fishing | **22,513,650** | 21,177,351 | **22,513,650** | 21,177,351 |
| Manufacturing | **50,116,479** | 42,467,362 | **50,116,479** | 42,467,362 |
| Tourism | **13,818,386** | 11,345,823 | **13,818,386** | 11,345,823 |
| Transport | **7,022,585** | 6,561,001 | **7,022,585** | 6,561,001 |
| Construction | **25,916,910** | 14,769,286 | **25,916,910** | 14,769,286 |
| Trading | **44,461,385** | 42,917,888 | **44,461,385** | 42,917,888 |
| Financial and business services | **9,856,842** | 8,285,786 | **9,856,842** | 8,285,786 |
| Infrastructure | **15,160,210** | 13,767,614 | **15,160,210** | 13,767,614 |
| Other services | **14,819,671** | 14,643,050 | **14,819,671** | 14,643,050 |
| Consumer durables | **8,006,853** | 8,096,930 | **8,006,853** | 8,096,930 |
| New economy | **1,585,722** | 1,399,681 | **1,585,722** | 1,399,681 |
| Others | **8,030,878** | 7,022,757 | **8,030,878** | 7,022,757 |
| **Gross loans and receivables** | **221,309,571** | 192,454,529 | **221,309,571** | 192,454,529 |

| As at | BANK 31.12.2017 LKR 000 | BANK 31.12.2016 LKR 000 | GROUP 31.12.2017 LKR 000 | GROUP 31.12.2016 LKR 000 |
|---|---|---|---|---|
| **30.2 Movements in Specific and Collective Allowance for Impairment** | | | | |
| **30.2.1 Specific Allowance for Impairment** | | | | |
| Balance at beginning | **4,778,752** | 4,240,756 | **4,778,752** | 4,240,756 |
| Charge to income statement | **724,402** | 792,389 | **724,402** | 792,389 |
| Effect of foreign currency movement | **21,782** | 22,903 | **21,782** | 22,903 |
| Write-off of loans and receivables | **(136,182)** | (277,296) | **(136,182)** | (277,296) |
| Balance on 31 December | **5,388,754** | 4,778,752 | **5,388,754** | 4,778,752 |
| **30.2.2 Collective Allowance for Impairment** | | | | |
| Balance at beginning | **1,890,798** | 1,924,882 | **1,890,798** | 1,924,882 |
| Charge to income statement | **405,973** | 81,772 | **405,973** | 81,772 |
| Effect of foreign currency movement | **382** | 3,712 | **382** | 3,712 |
| Transfer to dues on terminated leases* | **(4,671)** | (3,344) | **(4,671)** | (3,344) |
| Write-off of loans and receivables | **(47,531)** | (116,224) | **(47,531)** | (116,224) |
| Balance on 31 December | **2,244,951** | 1,890,798 | **2,244,951** | 1,890,798 |
| **Total** | **7,633,705** | 6,669,550 | **7,633,705** | 6,669,550 |

** Included in debtors in other assets Note 43.*

## 31 Financial Investments – Available for Sale

### Accounting Policy →

*Available-for-sale investments are non-derivative investments that were designated as available for sale or not classified as another category of financial assets. These include Treasury Bills, Bonds, Debt Securities and unquoted and quoted equity securities. They are carried at fair value except for unquoted equity securities whose fair value cannot reliably be measured and therefore carried at cost.*

*Interest income is recognised in profit or loss, using the effective interest method. Dividend income was recognised in profit or loss when the Bank become entitled to the dividend.*

*Fair value changes are recognised in other comprehensive income until the investment is sold or impaired, where upon the cumulative gains and losses previously recognised in other comprehensive income are reclassified to profit or loss as are classification adjustment.*

| As at | BANK 31.12.2017 LKR 000 | BANK 31.12.2016 LKR 000 | GROUP 31.12.2017 LKR 000 | GROUP 31.12.2016 LKR 000 |
|---|---|---|---|---|
| Government of Sri Lanka Treasury bills | **19,484,244** | 16,993,057 | **19,484,244** | 16,993,057 |
| Government of Sri Lanka Treasury bonds | **18,261,795** | 12,372,198 | **18,261,795** | 12,372,198 |
| Equity securities | | | | |
| Quoted (Note 31.1) | **18,195,008** | 18,797,640 | **18,195,008** | 18,797,640 |
| Unquoted (Note 31.2) | **85,555** | 112,484 | **85,555** | 112,484 |
| Preference shares (Note 31.3) | **500** | 500 | **500** | 500 |
| Quoted units in Unit Trust (Note 31.4) | **194,590** | 190,153 | **194,590** | 190,153 |
| Unquoted units in Unit Trust (Note 31.5) | **644,362** | 806,211 | **644,362** | 806,211 |
| **Total** | **56,866,054** | 49,272,243 | **56,866,054** | 49,272,243 |

All the financial investments are carried at fair value except for unquoted equity securities and irredeemable preference shares whose fair value cannot reliably be measured is carried at cost.

| As at | 31.12.2017 | | | 31.12.2016 | | |
|---|---|---|---|---|---|---|
| | Number of ordinary shares | Cost* LKR 000 | Fair value LKR 000 | Number of ordinary shares | Cost* LKR 000 | Fair value LKR 000 |

## 31.1 Quoted Ordinary Shares

| | | | | | | |
|---|---|---|---|---|---|---|
| **Banks, finance and insurance** | | | | | | |
| Commercial Bank of Ceylon PLC – voting | **126,696,192** | **4,839,953** | **17,230,682** | 122,747,994 | 3,508,069 | 17,798,459 |
| Commercial Bank of Ceylon PLC – non-voting | **257,805** | **20,790** | **27,070** | 230,726 | 18,246 | 26,649 |
| National Development Bank PLC | **2,076,280** | **364,017** | **283,412** | 2,000,000 | 352,369 | 312,000 |
| | | **5,224,760** | **17,541,164** | | 3,878,684 | 18,137,108 |
| **Beverages, Food and Tobacco** | | | | | | |
| Ceylon Tobacco Company PLC | **34,532** | **1,949** | **33,154** | 59,532 | 3,360 | 47,626 |
| | | **1,949** | **33,154** | | 3,360 | 47,626 |
| **Chemicals and Pharmaceuticals** | | | | | | |
| Chemical Industries (Colombo) PLC – voting | **247,900** | **14,131** | **16,535** | 247,900 | 14,131 | 22,311 |
| Chemical Industries (Colombo) PLC – non-voting | **389,400** | **15,577** | **20,249** | 389,400 | 15,577 | 26,479 |
| | | **29,708** | **36,784** | | 29,708 | 48,790 |
| **Construction and Engineering** | | | | | | |
| Access Engineering PLC | **473,000** | **9,737** | **11,163** | 473,000 | 9,737 | 11,730 |
| Colombo Dockyard PLC | **160,000** | **12,160** | **14,048** | 160,000 | 12,160 | 12,160 |
| | | **21,897** | **25,211** | | 21,897 | 23,890 |
| **Diversified Holdings** | | | | | | |
| Carson Cumberbatch PLC | **46,967** | **7,745** | **8,454** | 46,967 | 12,681 | 8,360 |
| Hayleys PLC | **7,333** | **2,225** | **1,760** | 7,333 | 2,225 | 1,980 |
| Hemas Holdings PLC | **496,560** | **16,297** | **62,567** | 496,560 | 16,297 | 49,159 |
| John Keells Holdings PLC | **219,907** | **18,362** | **32,700** | 219,907 | 18,362 | 31,886 |
| Melstacorp Limited | **1,669,940** | **69,829** | **99,361** | 1,669,940 | 69,829 | 100,196 |
| Richard Pieris & Co. PLC | **612,956** | **5,047** | **7,907** | 1,000,000 | 8,234 | 8,100 |
| | | **119,505** | **212,749** | | 127,628 | 199,681 |
| **Healthcare** | | | | | | |
| Ceylon Hospitals PLC – voting | **100,000** | **2,306** | **8,300** | 100,000 | 2,306 | 8,740 |
| Ceylon Hospitals PLC – non-voting | **240,000** | **4,167** | **15,672** | 240,000 | 4,167 | 17,976 |
| | | **6,473** | **23,972** | | 6,473 | 26,716 |
| **Hotels and Travels** | | | | | | |
| Dolphin Hotels PLC | **100,000** | **964** | **2,900** | 100,000 | 964 | 3,940 |
| | | **964** | **2,900** | | 964 | 3,940 |

Sector classification and fair value per share are based on the list published by Colombo Stock Exchange, as at the reporting date.

** Cost is reduced by write-off of diminution in value other than temporary in respect of investments.*

| As at | 31.12.2017 | | | 31.12.2016 | | |
|---|---|---|---|---|---|---|
| | Number of ordinary shares | Cost* LKR 000 | Fair value LKR 000 | Number of ordinary shares | Cost* LKR 000 | Fair value LKR 000 |
| **Investment Trusts** | | | | | | |
| Ceylon Guardian Investment Trust PLC | **152,308** | **5,918** | **13,251** | 152,308 | 5,918 | 17,058 |
| Ceylon Investment PLC | **288,309** | **9,428** | **12,887** | 288,309 | 9,429 | 14,704 |
| | | **15,346** | **26,138** | | 15,347 | 31,762 |
| **Telecommunications** | | | | | | |
| Dialog Axiata PLC | **2,050,000** | **18,860** | **26,855** | 2,050,000 | 18,860 | 21,525 |
| **Manufacturing** | | | | | | |
| ACL Cables PLC | **40,000** | **2,278** | **1,688** | – | – | – |
| Ceylon Grain Elevators PLC | **148,997** | **9,197** | **9,834** | 48,997 | 1,297 | 4,042 |
| Chevron Lubricants Lanka PLC | **761,628** | **27,907** | **90,634** | 761,628 | 27,907 | 119,576 |
| Kelani Tyres PLC | **75,000** | **4,538** | **3,330** | – | – | – |
| Piramal Glass Ceylon PLC | **5,000,000** | **14,024** | **29,000** | 5,000,000 | 14,024 | 26,500 |
| Royal Ceramics Lanka PLC | **139,800** | **16,996** | **16,007** | 139,800 | 16,996 | 16,217 |
| Teejay Lanka PLC | **75,000** | **3,141** | **2,550** | – | – | – |
| Tokyo Cement Company (Lanka) PLC – voting | **120,000** | **5,734** | **7,920** | 100,000 | 5,734 | 5,950 |
| Tokyo Cement Company (Lanka) PLC – non-voting | **1,472,515** | **25,759** | **86,878** | 1,227,096 | 25,759 | 63,196 |
| | **–** | **109,574** | **247,841** | | 91,717 | 235,481 |
| **Power & Energy** | | | | | | |
| Vallibel Power Erathna PLC | **2,400,000** | **6,400** | **18,240** | 2,400,000 | 6,400 | 21,120 |
| | | **6,400** | **18,240** | | 6,400 | 21,120 |
| **Total quoted ordinary shares – Bank** | | **5,555,436** | **18,195,008** | | 4,201,038 | 18,797,640 |
| Commercial Bank of Ceylon PLC – Equity Adjustment | | **2,297,772** | **–** | | 2,499,357 | – |
| **Total quoted ordinary shares – Group** | | **7,853,208** | **18,195,008** | | 6,700,395 | 18,797,640 |

Sector classification and fair value per share are based on the list published by Colombo Stock Exchange, as at the reporting date.

** Cost is reduced by write-off of diminution in value other than temporary in respect of Investments.*

| As at | 31.12.2017 | | 31.12.2016 | |
|---|---|---|---|---|
| | **Number of ordinary shares** | **Cost* LKR 000** | Number of ordinary shares | Cost* LKR 000 |
| ***31.2 Unquoted Ordinary Shares*** | | | | |
| Credit Information Bureau of Sri Lanka | **9,184** | **918** | 9,184 | 918 |
| Durdans Medical & Surgical Hospital (Pvt) Limited | **1,273,469** | **16,029** | 1,273,469 | 16,029 |
| Fitch Ratings Lanka Limited | **62,500** | **625** | 62,500 | 625 |
| Lanka Clear (Private) Limited | **100,000** | **1,000** | 100,000 | 1,000 |
| Lanka Financial Services Bureau Limited | **100,000** | **1,000** | 100,000 | 1,000 |
| Samson Reclaim Rubber Limited | **116,700** | **–** | 116,700 | 2,334 |
| Sinwa Holdings Limited | **–** | **–** | 460,000 | 9,200 |
| Society for Worldwide Interbank Financial Telecommunication | **6** | **3,385** | 6 | 3,385 |
| Sun Tan Beach Resorts Limited | **9,059,013** | **62,598** | 9,059,013 | 67,943 |
| The Video Team (Private) Limited | **30,000** | **–** | 30,000 | 300 |
| Wayamba Plantations (Private) Limited | **–** | **–** | 2,750,000 | 9,750 |
| **Total unquoted ordinary shares – Bank/Group** | | **85,555** | | 112,484 |

* *Cost is reduced by write-off of diminution in value other than temporary in respect of investments.*

| As at | 31.12.2017 | | | 31.12.2016 | | |
|---|---|---|---|---|---|---|
| | **Number of ordinary shares** | **Cost LKR 000** | **Fair value LKR 000** | Number of ordinary shares | Cost LKR 000 | Fair value LKR 000 |
| ***31.3 Unquoted Irredeemable Preference Shares*** | | | | | | |
| Arpico Finance Company PLC | **50,000** | **500** | **500** | 50,000 | 500 | 500 |
| **Total investments in unquoted irredeemable preference shares – Bank/Group** | | **500** | **500** | | 500 | 500 |

| As at | 31.12.2017 | | | 31.12.2016 | | |
|---|---|---|---|---|---|---|
| | **Number of units** | **Cost LKR 000** | **Fair value LKR 000** | Number of units | Cost LKR 000 | Fair value LKR 000 |
| ***31.4 Quoted Units in Unit Trust*** | | | | | | |
| NAMAL Acuity Value Fund | **2,112,810** | **106,070** | **194,590** | 2,112,810 | 106,070 | 190,153 |
| **Total investments in quoted unit – Bank/Group** | | **106,070** | **194,590** | | 106,070 | 190,153 |

| As at | 31.12.2017 | | | 31.12.2016 | | |
|---|---|---|---|---|---|---|
| | **Number of units** | **Cost LKR 000** | **Fair value LKR 000** | Number of units | Cost LKR 000 | Fair value LKR 000 |

## *31.5 Unquoted Units in Unit Trust*

| | | | | | | |
|---|---|---|---|---|---|---|
| NAMAL Growth Fund | **2,125,766** | **251,539** | **288,256** | 2,125,766 | 251,539 | 272,867 |
| NAMAL Income Fund | **5,810,424** | **59,322** | **80,778** | 11,162,129 | 113,961 | 143,719 |
| NAMAL Money Market Fund | – | – | – | 11,679,366 | 118,457 | 125,616 |
| National Equity Fund | **250,000** | **2,657** | **8,417** | 250,000 | 2,657 | 8,352 |
| Guardian Acuity Equity Fund | **9,052,505** | **150,000** | **154,486** | 9,052,504 | 150,000 | 151,432 |
| JB Vantage Value Equity Fund | **5,224,660** | **100,000** | **112,425** | 5,224,660 | 100,000 | 104,225 |
| **Total investments in unquoted unit trusts – Bank/Group** | | **563,518** | **644,362** | | 736,614 | 806,211 |

| As at | Ordinary Shares | | Preference | Unit Trusts | | Total | |
|---|---|---|---|---|---|---|---|
| | **Quoted LKR 000** | **Unquoted LKR 000** | **Unquoted LKR 000** | Quoted LKR 000 | Unquoted LKR 000 | **31.12.2017 LKR 000** | 31.12.2016 LKR 000 |

## *31.6 Equity Securities*

### *31.6.1 Composition **

#### 31.6.1.1 Bank

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Performing investments | 18,180,960 | 22,957 | 500 | 194,590 | 356,107 | **18,755,114** | 19,556,127 |
| Non-performing investments | 14,048 | 62,598 | – | – | 288,255 | **364,901** | 350,860 |
| | 18,195,008 | 85,555 | 500 | 194,590 | 644,362 | **19,120,015** | 19,906,987 |

#### *31.6.1.2 Group*

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Performing investments | 18,180,960 | 22,957 | 500 | 194,590 | 356,107 | **18,755,114** | 19,556,127 |
| Non-performing investments | 14,048 | 62,598 | – | – | 288,255 | **364,901** | 350,860 |
| | 18,195,008 | 85,555 | 500 | 194,590 | 644,362 | **19,120,015** | 19,906,987 |

** Disclosure as per the direction on the prudential norms for classification, valuation and operation of the Bank's investment portfolio.*

## 32 Financial Investments – Held-to-maturity

### *Accounting Policy →*

*Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that Bank positively intends, and is able, to hold to maturity. Held-to-maturity investments are initially recorded at fair value plus any directly attributable transaction costs, and are subsequently measured at amortised cost using the effective interest rate method, less any impairment losses.*

*A sale or reclassification of a more than insignificant amount of held-to-maturity investments would result in there classification of all investment securities as available for sale for the current and the subsequent two financial years.*

*However, sales and reclassifications in any of the following circumstances would not trigger a reclassification:*

- *Sales or reclassifications that are so close to maturity that changes in the market rate of interest would not have a significant effect on the financial asset's fair value;*
- *Sales or reclassifications after the Bank has collected substantially all of the asset's original principal; and*
- *Sales or reclassifications attributable to non-recurring isolated events beyond the Group's control that could not have been reasonably anticipated.*

| | BANK | | GROUP | |
|---|---|---|---|---|
| *As at* | **31.12.2017 LKR 000** | 31.12.2016 LKR 000 | **31.12.2017 LKR 000** | 31.12.2016 LKR 000 |
| Quoted debentures (Note 32.1) | **5,131,404** | 5,949,747 | **5,131,404** | 5,949,747 |
| **Sri Lanka Government Securities** | | | | |
| Treasury Bills | **941,938** | 2,357,188 | **941,938** | 2,357,188 |
| Treasury Bonds | **17,434,290** | 14,882,150 | **17,434,290** | 14,882,150 |
| **Total** | **23,507,632** | 23,189,085 | **23,507,632** | 23,189,085 |

| | **31.12.2017** | | 31.12.2016 | |
|---|---|---|---|---|
| *As at* | **Number of debentures** | **Cost of investment LKR 000** | Number of debentures | **Cost of investment** LKR 000 |
| ***32.1 Quoted Debentures*** | | | | |
| Abans Limited | – | – | 2,500,000 | 267,917 |
| Access Engineering PLC | **2,500,000** | **253,031** | 2,500,000 | 253,031 |
| Alliance Finance Company PLC | **4,221,693** | **461,755** | 5,721,693 | 623,823 |
| Central Finance Company PLC | **1,793,900** | **191,604** | 2,075,700 | 221,626 |
| Commercial Credit & Finance PLC | **4,500,000** | **461,913** | 4,500,000 | 461,879 |
| HDFC Bank | – | – | 532,200 | 55,227 |
| Hemas Holdings PLC | **827,900** | **85,055** | 827,900 | 85,049 |
| Lanka Orix Leasing Company PLC | **3,000,000** | **306,806** | 3,000,000 | 306,787 |
| LB Finance PLC | **1,155,200** | **116,344** | – | – |
| Lion Brewery (Ceylon) PLC | **1,440,900** | **173,420** | 1,462,200 | 195,446 |
| People's Leasing and Finance PLC | **13,326,300** | **1,391,594** | 13,326,300 | 1,391,578 |
| Richard Pieris and Company PLC | – | – | 1,201,000 | 123,303 |
| Senkadagala Finance PLC | **3,650,000** | **371,981** | 3,650,000 | 371,981 |
| Singer (Sri Lanka) PLC | **6,441,900** | **668,738** | 8,975,800 | 942,964 |
| Siyapatha Finance Limited | **2,000,000** | **217,802** | 2,000,000 | 217,802 |
| Softlogic Finance PLC | **706,500** | **72,431** | 706,500 | 72,429 |
| Vallibel Finance PLC | **3,500,000** | **358,930** | 3,500,000 | 358,905 |
| **Total investments in quoted debentures – Bank/Group** | | 5,131,404 | | 5,949,747 |

## 33 Investments in Subsidiaries

### *Accounting Policy →*

*Bank's investments in subsidiaries are stated at cost less impairment losses. Reversals of impairment losses are recognised in the income statement, if there has been a change in the estimates used to determine the recoverable amount of the investment.*

| *As at* | DFCC Consulting (Pvt) Limited ownership 100% LKR 000 | Lanka Industrial Estates Limited ownership 51.16% LKR 000 | Synapsys Limited ownership 100% LKR 000 | BANK **31.12.2017** **LKR 000** | BANK 31.12.2016 LKR 000 |
|---|---|---|---|---|---|
| Balance at beginning | 5,000 | 97,036 | 70,000 | **172,036** | 172,036 |
| Investments during the year | – | – | 65,000 | **65,000** | – |
| Less: Allowance for impairment (Note 33.1) | – | – | 70,000 | **70,000** | 60,104 |
| Balance net of impairment at the end | 5,000 | 97,036 | 65,000 | **167,036** | 111,932 |

### *33.1 Movements in Impairment Allowance*

| | | |
|---|---|---|
| Balance at beginning | 60,104 | 39,181 |
| Charge to income statement | 9,896 | 20,923 |
| Balance on 31 December | 70,000 | 60,104 |

Investment in Synapsys Limited is classified as non-performing (no dividend for three consecutive years).

### *33.2 Non-Controlling Interest (NCI) in Subsidiaries*

### *Accounting Policy →*

*The Non-Controlling Interest are measured at their proportionate share of the acquiree's identifiable net assets at the date of acquisition. Changes in the Group's interest in a subsidiary that do not result in a loss of control are accounted for as equity transactions.*

| | **Percentage of ownership interest held by NCI** | Percentage of voting rights held by NCI | Share of total comprehensive income of NCI for the year ended | | NCI as at | | Dividends paid to NCI for the year ended | |
|---|---|---|---|---|---|---|---|---|
| | **31.12.2017 %** | 31.12.2016 % | **31.12.2017 LKR 000** | 31.12.2016 LKR 000 | **31.12.2017 LKR 000** | 31.12.2016 LKR 000 | **31.12.2017 LKR 000** | 31.12.2016 LKR 000 |
| Lanka Industrial Estates Limited | **48.84** | 48.84 | **71,572** | 54,270 | **276,872** | 259,900 | **54,600** | 46,796 |
| | | | **71,572** | 54,270 | **276,872** | 259,900 | **54,600** | 46,796 |

### *33.3 Summarised Financial Information of Subsidiaries*

### *Lanka Industrial Estates Limited*

| *As at* | 31.12.2017 LKR 000 | 31.12.2016 LKR 000 |
|---|---|---|
| Assets | **782,569** | 702,868 |
| Liabilities | **215,730** | 170,777 |
| Equity | **566,839** | 532,091 |
| *For the year ended* | | |
| Revenue | **322,161** | 293,687 |
| Profit after tax | **146,078** | 110,748 |
| Other comprehensive income | **456** | 361 |
| Total comprehensive income | **146,534** | 111,109 |

## 34 *Investments in Associate (Unquoted)*

### *Accounting Policy →*

*Investments in associates are recognised using the equity method, initially stated at cost, including attributable goodwill, and are adjusted thereafter for the post-acquisition change in Bank's share of net assets.*

*Unrealised gains on transactions between Bank and its associates are eliminated to the extent of Bank's interest in the respective associate. Unrealised losses are also eliminated to the extent of Bank's interest in the associate.*

| | BANK | | GROUP | |
|---|---|---|---|---|
| *As at* | **31.12.2017 LKR 000** | 31.12.2016 LKR 000 | **31.12.2017 LKR 000** | 31.12.2016 LKR 000 |
| **National Asset Management Limited (Ownership 30%)** | | | | |
| Balance at beginning | **35,270** | 35,270 | **64,873** | 66,980 |
| Share of profit after tax | **–** | – | **9,414** | 11,752 |
| Share of other comprehensive income/(expenses) | **–** | – | **479** | (3,359) |
| Dividend received – Elimination on consolidation | **–** | – | **(7,500)** | (10,500) |
| Balance on 31 December | **35,270** | 35,270 | **67,266** | 64,873 |

### *34.1 Summarised Financial Information of Associate*

### National Asset Management Limited

| *As at* | 31.12.2017 LKR 000 | 31.12.2016 LKR 000 |
|---|---|---|
| Assets | **238,743** | 239,051 |
| Liabilities | **14,576** | 22,861 |
| Equity | **224,167** | 216,190 |
| *For the year ended* | | |
| Revenue | **128,102** | 134,075 |
| Profit after tax | **31,380** | 39,174 |
| Other comprehensive income/(expenses) | **1,596** | (11,198) |
| Total comprehensive income | **32,976** | 27,976 |

## 35 Investments in Joint Venture (Unquoted)

### Accounting Policy →

*Investments in Joint Ventures are recognised using the equity method, initially stated at cost, including attributable goodwill, and are adjusted thereafter for the post-acquisition change in Bank's share of net assets.*

*Unrealised gains on transactions between Bank and its Joint Ventures are eliminated to the extent of Bank's interest in the respective Joint Ventures. Unrealised losses are also eliminated to the extent of Bank's interest in the Joint Ventures.*

| *As at* | **31.12.2017 Cost of investment LKR 000** | 31.12.2016 Cost of investment LKR 000 |
|---|---|---|
| **35.1 Investments in Joint Venture – Bank** | | |
| Acuity Partners (Pvt) Limited (ownership 50%) | **755,000** | 755,000 |
| | **755,000** | 755,000 |

| *As at* | **31.12.2017 LKR 000** | **31.12.2016 LKR 000** |
|---|---|---|
| **35.2 Investment in Joint Venture – Group** | | |
| Share of identifiable asset and liabilities of joint venture as at the beginning of the year | **1,562,942** | 1,365,507 |
| Share of unrealised profit on disposal of investments | **(184,688)** | (184,688) |
| Balance at beginning | **1,378,254** | 1,180,819 |
| Investment made during the year | **–** | 100,000 |
| Share of profit net of tax | **175,616** | 149,399 |
| Share of other comprehensive income | **(21,416)** | (21,154) |
| Change in holding – through subsidiary of joint venture | **117,478** | (610) |
| Dividend received during the year | **(33,220)** | (30,200) |
| Group's share of net assets | **1,616,711** | 1,378,254 |

### 35.3 Summarised Financial Information of Joint Venture – Acuity Partners (Pvt) Limited

| *For the year ended* | **31.12.2017 Cost of investment LKR 000** | 31.12.2016 Cost of investment LKR 000 |
|---|---|---|
| Revenue | **808,127** | 671,603 |
| Depreciation | **48,601** | 34,654 |
| Income tax expense | **50,241** | 61,499 |
| Profit after tax | **564,879** | 534,885 |
| Other comprehensive expenses | **(69,456)** | (48,143) |
| Total comprehensive income | **495,423** | 486,742 |

| As at | 31.12.2017 LKR 000 | 31.12.2016 LKR 000 |
|---|---|---|
| Current assets | **5,241,692** | 4,085,610 |
| Non-current assets | **9,299,827** | 7,488,394 |
| Current liabilities | **7,688,029** | 6,098,931 |
| Non-current liabilities | **1,025,766** | 1,063,494 |

| | BANK | |
|---|---|---|
| As at | 31.12.2017 LKR 000 | 31.12.2016 LKR 000 |

## 36 Due from Subsidiaries

| | | |
|---|---|---|
| DFCC Consulting (Pvt) Limited | **906** | 2,265 |
| Synapsys Limited | **11,177** | 17,590 |
| | **12,083** | 19,855 |

## 37 Investment Property

### *Accounting Policy →*

*Investment property of the Group (held by Subsidiary Lanka Industrial Estates Limited) is property held either to earn rental income or for capital appreciation or for both, but not for sale in the ordinary course of business. The Group has chosen the cost model instead of fair value model and therefore investment property is measured at cost. Cost includes expenditure that is directly attributable to the acquisition of the investment property.*

*Any gain or loss on disposal of an investment property (calculated as the difference between the next proceeds from disposal and the carrying amount of the item) is recognised in the Income Statement.*

| | GROUP | |
|---|---|---|
| As at | 31.12.2017 LKR 000 | 31.12.2016 LKR 000 |
| **Cost** | | |
| Balance at beginning | **363,329** | 313,909 |
| Acquisition | **165,336** | 49,420 |
| Transfers | **(64,317)** | – |
| **Cost as at 31 December** | **464,348** | 363,329 |
| **Less: Accumulated Depreciation** | | |
| Balance at beginning | **131,977** | 118,177 |
| Charge for the year | **13,718** | 13,800 |
| **Accumulated depreciation as at 31 December** | **145,695** | 131,977 |
| Carrying amount as at 31 December | **318,653** | 231,352 |

| As at 31 December 2017 | Buildings sq.ft | Extent of Land perches* | Cost LKR 000 | Accumulated depreciation/ impairment LKR 000 | Net Book value LKR 000 | Fair value LKR 000 |
|---|---|---|---|---|---|---|
| ***37.1 Details of Investment Properties*** | | | | | | |
| Pattiwila Road, Sapugaskanda, Makola | 280,000 | 20,000 | 464,348 | 145,695 | 318,653 | 2,344,314 |

** 1 Perch = 25.2929 m²; 1 Sq. ft = 0.0929 m²*

The fair value of investment property as at 31 December 2017 situated at Pattiwila Road, Sapugaskanda, Makola was based on market valuations carried out in December 2016 by Mr P B Kalugalagedara, Fellow Members of Institute of Valuers (Sri Lanka), Chartered Valuer.

Rental income from investment property of Group for 2017, LKR 225 million (2016 – LKR 198 million).
Operating expenses on investment property of Group for 2017 – LKR 29 million (2016 – LKR 28 million).

## 38 Property, Plant and Equipment

### Accounting Policy →

#### Recognition and Measurement

*Items of property, plant and equipment are measured at cost less accumulated depreciation and any accumulated impairment losses.*

*Cost includes expenditure that is directly attributable to the acquisition of the asset.*

*Any gain or loss on disposal of an item of property, plant and equipment (calculated as the difference between the net proceeds from disposal and the carrying amount of the item) is recognised in the income statement.*

#### Subsequent Costs

*Subsequent expenditure is capitalised only when it is probable that the future economic benefits of the expenditure will flow to the Bank. Ongoing repairs and maintenance costs are expensed as incurred.*

#### Capital work-in-Progress

*These are expenses of a capital nature directly incurred in the construction of buildings, major plant and machinery and system development, awaiting capitalisation. These are stated in the Statement of Financial Position at cost. Capital work-in-progress would be transfered to the relevant asset when it is available for use i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Capital work-in-progress is stated at cost less any accumulated impairment losses.*

#### Depreciation

*Items of property, plant and equipment are depreciated from the month they are available for use up to the month of disposal. Depreciation is calculated to write-off the cost of items of property, plant and equipment less their estimated residual values using the straight-line basis over their estimated useful lives. Land is not depreciated.*

*The estimated useful lives for the current and comparative periods of significant items of property, plant and equipment are as follows:*

| | Years |
|---|---|
| Buildings | 20 |
| Office equipment and motor vehicles | 5 |
| Fixtures and fittings | 10 |

#### Derecognition

*The carrying amount of property and equipment is derecognised on disposal or when no-future economic benefits are expected from its use of the gain or loss arising from the derecognition (calculated as the difference between the net proceeds from disposal and the carrying amount of the item) is recognised in the income statement.*

| | Land and buildings LKR 000 | Office equipment LKR 000 | Furniture and fittings LKR 000 | Motor vehicles LKR 000 | **Total 31.12.2017 LKR 000** | Total 31.12.2016 LKR 000 |
|---|---|---|---|---|---|---|
| ***38.1 Composition: Bank*** | | | | | | |
| Cost at beginning | 467,861 | 1,573,810 | 840,181 | 269,276 | **3,151,128** | 2,947,897 |
| Acquisitions | 11,324 | 486,099 | 85,664 | 22,210 | **605,297** | 218,550 |
| Less: Disposals | – | 16,228 | 911 | 30,404 | **47,543** | 15,319 |
| Cost as at 31 December | 479,185 | 2,043,681 | 924,934 | 261,082 | **3,708,882** | 3,151,128 |
| Accumulated depreciation at beginning | 214,541 | 1,238,231 | 524,366 | 246,133 | **2,223,271** | 2,004,880 |
| Depreciation for the years | 18,833 | 158,558 | 67,820 | 14,337 | **259,548** | 233,079 |
| Less: Accumulated depreciation on disposals | – | 16,183 | 599 | 30,405 | **47,187** | 14,688 |
| Accumulated depreciation as at 31 December | 233,374 | 1,380,606 | 591,587 | 230,065 | **2,435,632** | 2,223,271 |
| Carrying amount as at 31 December | 245,811 | 663,075 | 333,347 | 31,017 | **1,273,250** | 927,857 |

| *As at 31 December 2017* | Buildings Sq. Ft. | Extent of land Perches* | Cost LKR 000 | Accumulated depreciation LKR 000 | Net book value LKR 000 |
|---|---|---|---|---|---|
| ***38.1.1 List of Freehold Land and Buildings*** | | | | | |
| 73/5, Galle Road, Colombo 3 | 57,190 | 106.81 | 85,518 | 75,716 | 9,802 |
| 5, Deva Veediya, Kandy | 6,260 | 12.54 | 16,195 | 7,408 | 8,787 |
| 259/30, Kandy Road, Bambarakelle, Nuwara-Eliya | – | 93.5 | 7,279 | – | 7,279 |
| 73, W A D Ramanayake Mawatha, Colombo 2 | 37,538 | 45.00 | 197,268 | 132,537 | 64,731 |
| 4 A, 4th Cross Lane, Borupana, Ratmalana | – | 20.00 | 2,600 | – | 2,600 |
| 454, Main Street, Negombo | 19,087 | 29.00 | 170,325 | 17,713 | 152,612 |
| | | | 479,185 | 233,374 | 245,811 |

** 1 perch = 25.2929m²; 1 sq ft = 0.0929m²*

| | LKR million | Date of valuation |
|---|---|---|
| ***38.1.2 Market Value of Properties*** | | |
| 73/5, Galle Road, Colombo 3 | 1,509 | 31.12.2017 |
| 5, Deva Veediya, Kandy | 125 | 31.12.2017 |
| 73, W A D Ramanayake Mawatha, Colombo 2 | 705 | 31.12.2017 |
| 4 A, 4th Cross Lane, Borupana, Ratmalana | 15 | 31.12.2017 |
| 454, Main Street, Negombo | 250 | 05.05.2015 |
| 259/30, Kandy Road, Bambarakelle, Nuwara-Eliya | 80 | 26.05.2015 |

(Valued by Mr A A M Fathihu – Former Government Chief Valuer and Mr J S M I B Karunatilaka, Associate Member of the Institute of Valuers of Sri Lanka).

### 38.1.3 Fully-Depreciated Property, Plant and Equipment – Bank

The initial cost of fully-depreciated property, plant and equipment as at 31 December 2017, which are still in use as at the reporting date is as follows:

| | BANK | |
|---|---|---|
| *As at* | **31.12.2017 LKR 000** | 31.12.2016 LKR 000 |
| Buildings | **79,312** | 58,739 |
| Office equipment | **1,007,584** | 909,043 |
| Furniture and fittings | **267,954** | 158,184 |
| Motor vehicles | **199,691** | 183,925 |
| | **1,554,541** | 1,309,891 |

### 38.2 Composition – Group

| | Land & buildings LKR 000 | Office equipment LKR 000 | Furniture & fittings LKR 000 | Motor vehicles LKR 000 | **Total 31.12.2017 LKR 000** | Total 31.12.2016 LKR 000 |
|---|---|---|---|---|---|---|
| Cost at beginning | 691,570 | 1,620,996 | 853,094 | 320,850 | **3,486,510** | 3,254,738 |
| Acquisitions | 18,492 | 488,220 | 86,390 | 22,210 | **615,312** | 258,492 |
| Less: Disposals | – | 16,799 | 911 | 30,651 | **48,361** | 26,360 |
| Write-off | – | – | – | – | – | 360 |
| Cost as at 31 December | 710,062 | 2,092,417 | 938,573 | 312,409 | **4,053,461** | 3,486,510 |
| Accumulated depreciation at beginning | 356,983 | 1,268,873 | 541,168 | 276,867 | **2,443,891** | 2,212,437 |
| Depreciation for the year | 31,092 | 164,642 | 68,811 | 21,879 | **286,424** | 257,532 |
| Less: Accumulated depreciation on disposals | – | 16,764 | 599 | 30,652 | **48,015** | 25,718 |
| Write-off | – | – | – | – | – | 360 |
| Accumulated depreciation as at 31 December | 388,075 | 1,416,751 | 609,380 | 268,094 | **2,682,300** | 2,443,891 |
| Carrying amount as at 31 December | 321,987 | 675,666 | 329,193 | 44,315 | **1,371,161** | 1,042,619 |

## 39 Intangible Assets

### *Accounting Policy* →

**Intangible Assets – Computer Application Software**

*All software licensed for use by the Bank, not constituting an integral part of related hardware are included in the statement of financial position under the category intangible assets and carried at cost less cumulative amortisation and any impairment losses.*

*The initial acquisition cost comprises licence fee paid at the inception, import duties, non-refundable taxes and levies, cost of customising the software to meet the specific requirements of the Bank and other directly attributable expenditure in preparing the asset for its intended use.*

*The initial cost is enhanced by subsequent expenditure incurred by further customisation to meet ancillary transaction processing and reporting requirements tailor-made for the use of the Bank constituting an improvement to the software.*

*The cost is amortised, using the straight-line method, at the rate of 20% per annum commencing from the date the application software is available-for-use. The amortised amount is based on the best estimate of its useful life, such that the cost is amortised fully at the end of the useful life during which the Bank has legal right of use. The amortisation cost is recognised as an expense.*

*An intangible asset is derecognised on disposal or when no future economic benefits are expected from its use and subsequent disposal.*

| As at | BANK 31.12.2017 LKR 000 | BANK 31.12.2016 LKR 000 | GROUP 31.12.2017 LKR 000 | GROUP 31.12.2016 LKR 000 |
|---|---|---|---|---|
| Software (refer 39.1) | **369,777** | 203,742 | **374,104** | 208,382 |
| Software under development (refer 39.2) | **128,307** | – | **128,307** | – |
| Total | **498,084** | 203,742 | **502,411** | 208,382 |

### 39.1 Software

| | | | | |
|---|---|---|---|---|
| Cost at beginning | **1,024,450** | 1,313,816 | **1,031,330** | 1,316,581 |
| Acquisitions | **275,608** | 58,833 | **276,529** | 62,948 |
| Less: Write-off* | – | 348,199 | – | 348,199 |
| Cost as at 31 December | **1,300,058** | 1,024,450 | **1,307,859** | 1,031,330 |
| Accumulated amortisation at beginning | **820,708** | 1,066,701 | **822,948** | 1,068,636 |
| Amortisation for the year | **109,573** | 98,262 | **110,807** | 98,567 |
| Less: Write-off* | – | 344,255 | – | 344,255 |
| Accumulated amortisation as at 31 December | **930,281** | 820,708 | **933,755** | 822,948 |
| Carrying amount as at 31 December | **369,777** | 203,742 | **374,104** | 208,382 |

** Software not in use*

| As at | BANK 31.12.2017 LKR 000 | BANK 31.12.2016 LKR 000 | GROUP 31.12.2017 LKR 000 | GROUP 31.12.2016 LKR 000 |
|---|---|---|---|---|

### 39.2 Software Under Development

| | | | | |
|---|---|---|---|---|
| As at begining | – | – | – | – |
| Addition to working progress | **128,307** | – | **128,307** | – |
| Transfers/adjustments | – | – | – | – |
| As at 31 December | **128,307** | – | **128,307** | – |

## 40 Goodwill on Consolidation

### Accounting Policy →

*Goodwill arises on the acquisition of subsidiaries, when the aggregate of the fair value of the consideration transferred, the amount of any non-controlling interest and the fair value of any previously held equity interest in the acquire exceed the amount of the identifiable assets and liabilities acquired. If the amount of the identifiable assets and liabilities acquired is greater, the difference is recognised immediately in the income statement. Goodwill arises on the acquisition of interests in joint ventures and associates when the cost of investment exceeds Bank's share of the net fair value of the associate's or joint venture's identifiable assets and liabilities.*

| As at | GROUP 31.12.2017 LKR 000 | GROUP 31.12.2016 LKR 000 |
|---|---|---|
| DFCC Vardhana Bank PLC | **146,603** | 146,603 |
| Lanka Industrial Estates Limited | **9,623** | **9,623** |
| | **156,226** | 156,226 |

In accordance with the provisions of part VIII of the Companies Act, DFCC Vardhana Bank PLC (DVB) has been amalgamated with DFCC Bank PLC with effect from 1 October 2015. The amalgamation between two entities is considered as a common control transaction, as DFCC Bank continues to control the operations of DVB after amalgamation. Thus the results of amalgamation of two entities are economically the same before and after the amalgamation as the entity will have identical net assets. Therefore, DFCC will continue to record carrying values including the remaining goodwill that resulted from the original acquisition of DVB in the consolidated financial status.

## 41 Government Grant Receivable/Deferred Income – CBSL Swap

### Accounting Policy →

*Government grants are recognised initially as deferred income at fair value, when there is a reasonable assurance that they will be received and Group will comply with the conditions associated with the grant, and are then recognised in profit or loss as other income on a systematic basis in the period in which the expenses (losses) are recognised.*

| As at | BANK | | GROUP | |
|---|---|---|---|---|
| | **31.12.2017 LKR 000** | 31.12.2016 LKR 000 | **31.12.2017 LKR 000** | 31.12.2016 LKR 000 |
| ***41.1 Government Grant – Receivable*** | | | | |
| Fair value at beginning | **861,915** | 539,758 | **861,915** | 539,758 |
| Change in fair value on the renewal of contract | **(133,055)** | 405,763 | **(133,055)** | 405,763 |
| Change in fair value during the year | **(86,277)** | (83,606) | **(86,277)** | (83,606) |
| Fair value at 31 December | **642,583** | 861,915 | **642,583** | 861,915 |
| ***41.2 Government Grant – Deferred Income*** | | | | |
| Fair value at beginning | **701,665** | 476,008 | **701,665** | 476,008 |
| Change in fair value on the renewal of contract | **(133,055)** | 405,763 | **(133,055)** | 405,763 |
| Change in fair value during the year | **(86,277)** | (83,606) | **(86,277)** | (83,606) |
| Foreign exchange gain/(loss) on revaluation | **172,250** | (96,500) | **172,250** | (96,500) |
| Amortisation of deferred income on Government grant – CBSL Swap | **85,973** | (180,106) | **85,973** | (180,106) |
| Fair value at 31 December | **654,583** | 701,665 | **654,583** | 701,665 |

DFCC Bank PLC in October 2013 raised USD 100 million by Issue of Notes abroad repayable in October 2018. The proceeds of this note issue are to be deployed predominantly in LKR denominated monetary assets. In order to hedge the resulting net open foreign currency liability position, DFCC Bank PLC has entered into a annualy renewable currency SWAP arrangement with Central Bank of Sri Lanka (CBSL) for 75% of the US Dollar (USD) denominated liability. Accordingly this contract was renewed in November 2016.

The currency SWAP arrangement, pursuant to Government policy for the principal amount only is designed to reimburse DFCC Bank by CBSL for any exchange loss incurred and conversely for DFCC Bank to pay CBSL any exchange gain arising from depreciation of LKR *vis-a-vis* USD or appreciation of LKR *vis-a-vis* USD respectively.

Although, USD denominated notes are repayable at the end of 5 years, the currency SWAP arrangement contract is renewed annually up to the date of repayment of the notes so as to exchange cash flow arising from movement in USD/LKR spot exchange rate that occurs at the time of renewal of the annual contract.

The currency SWAP arrangement with CBSL provides for SWAP of LKR to USD at the end of the contract at the same spot rate as the initial SWAP of USD to LKR at the commencement of the annual contract. (i.e. CBSL SWAP arrangement amounts to a full discount to USD LKR spot rate at the end of the contract.)

The hedging instrument for currency swap is deemed to be a derivative asset recognised at the fair value at the inception of the contract.

The fair value of this derivative asset is measured by reference to forward exchange quotes for USD purchase contracts by commercial banks, who are the normal market participants. Thus the fair value gain at the inception of the contract is the full amount of the forward premium quote at the end of one year.

The subsequent change in fair value is recognised in the income statement.

CBSL normally does not enter into forward exchange contracts with market participants providing 100% discount to the USD LKR spot rate at the time of the maturity of the contract. Thus this arrangement has features of both derivative instrument and Government grant through the agency of CBSL.

The initial gain by reference to forward price of an equivalent forward exchange dollar purchase contract is recognised as a Government grant and deferred income.

The deferred income is amortised on a systematic basis over the period in which the Bank recognises the fall in value of derivative which the grant is intended to compensate.

| | BANK | | GROUP | |
|---|---|---|---|---|
| *As at* | **31.12.2017 LKR 000** | 31.12.2016 LKR 000 | **31.12.2017 LKR 000** | 31.12.2016 LKR 000 |
| **42 Deferred Tax Asset/Liability** | | | | |
| Deferred tax liability (Note 42.1) | **1,194,027** | 851,662 | **1,232,478** | 873,912 |
| Deferred tax asset (Note 42.2) | **–** | – | **3,160** | 628 |
| Net total | **1,194,027** | 851,662 | **1,229,318** | 873,284 |
| **42.1 Deferred Tax Liability** | | | | |
| Balance at beginning | **991,492** | 1,021,744 | **1,013,742** | 1,022,192 |
| Recognised in income statement | **87,393** | (30,252) | **103,594** | (8,002) |
| Recognised in other comprehensive income | **190,583** | – | **190,583** | (448) |
| | **1,269,468** | 991,492 | **1,307,919** | 1,013,742 |
| Transferred from deferred tax asset | **(75,441)** | (139,830) | **(75,441)** | (139,830) |
| Balance as at 31 December | **1,194,027** | 851,662 | **1,232,478** | 873,912 |

| As at | BANK 31.12.2017 LKR 000 | BANK 31.12.2016 LKR 000 | GROUP 31.12.2017 LKR 000 | GROUP 31.12.2016 LKR 000 |
|---|---|---|---|---|
| ***42.2 Deferred Tax Asset*** | | | | |
| Balance at beginning | **139,830** | 141,254 | **140,458** | 143,238 |
| Recognised in income statement | **10,973** | (69,953) | **14,048** | (70,623) |
| Recognised in other comprehensive income | **(75,362)** | 68,529 | **(75,905)** | 67,843 |
| | **75,441** | 139,830 | **78,601** | 140,458 |
| Offset against deferred tax liability | **(75,441)** | (139,830) | **(75,441)** | (139,830) |
| Balance as at 31 December | **–** | – | **3,160** | 628 |

## *42.3 Recognised Deferred Tax Assets and Liabilities*

| | BANK 31.12.2017 LKR 000 | BANK 31.12.2016 LKR 000 | GROUP 31.12.2017 LKR 000 | GROUP 31.12.2016 LKR 000 |
|---|---|---|---|---|
| **Assets** | | | | |
| Property, equipment and software | **–** | – | **(898)** | (1,234) |
| Gratuity liability and actuarial losses on defined benefit plans | **75,441** | 61,868 | **79,499** | 63,730 |
| Fair value of available-for-sale financial assets | **–** | 77,962 | **–** | 77,962 |
| | **75,441** | 139,830 | **78,601** | 140,458 |
| **Liabilities** | | | | |
| Property, equipment and software | **176,168** | 133,762 | **200,418** | 156,012 |
| Finance leases | **902,717** | 857,730 | **902,717** | 857,730 |
| Fair value of available-for-sale financial assets | **190,583** | – | **190,583** | – |
| Undistributed profits of the group | **–** | – | **14,201** | – |
| | **1,269,468** | 991,492 | **1,307,919** | 1,013,742 |

### *42.3.1 Tax on Gains on Disposal*

With the introduction of new Inland Revenue Act No. 24 of 2017 the business assets/capital assets will attract tax at the corporate tax rate on the gains at the time of disposal. Accordingly deferred tax liability is expected to be provided for free hold land. However as the Bank/Group is under cost model, no deferred tax liability has been provided in these Financial Statements.

| As at | BANK 31.12.2017 LKR 000 | BANK 31.12.2016 LKR 000 | GROUP 31.12.2017 LKR 000 | GROUP 31.12.2016 LKR 000 |
|---|---|---|---|---|
| ***42.4 Unrecognised Deferred Tax Assets*** | | | | |
| Accumulated tax losses | | | | |
| DFCC Consulting (Pvt) Limited – Subsidiary | **–** | – | **5,956** | 6,114 |
| Synapsys Limited – Subsidiary | **–** | – | **6,972** | 7,321 |
| | **–** | – | **12,928** | 13,435 |

| As at | BANK 31.12.2017 LKR 000 | BANK 31.12.2016 LKR 000 | GROUP 31.12.2017 LKR 000 | GROUP 31.12.2016 LKR 000 |
|---|---|---|---|---|

## 43 Other Assets

| | | | | |
|---|---|---|---|---|
| Refundable deposits and advances | **370,300** | 323,819 | **372,070** | 330,694 |
| Debtors | **805,204** | 720,796 | **834,334** | 760,598 |
| Clearing account balances | **1,600,238** | 1,521,021 | **1,600,238** | 1,521,021 |
| Receivable from pension fund | **181,820** | 165,363 | **181,820** | 165,363 |
| | **2,957,562** | 2,730,999 | **2,988,462** | 2,777,676 |

## 44 Due to Banks

| | | | | |
|---|---|---|---|---|
| Balances with foreign banks | **1,067,474** | 1,536,573 | **1,067,474** | 1,536,573 |
| Borrowing – local banks | **8,573,261** | 12,063,868 | **8,573,261** | 12,063,868 |
| Securities sold under repurchase (Repo) agreements | **–** | 4,503,146 | **–** | 4,503,146 |
| | **9,640,735** | 18,103,587 | **9,640,735** | 18,103,587 |

## 45 Due to Other Customers

| | | | | |
|---|---|---|---|---|
| Total amount due to other customers | **193,307,534** | 140,514,373 | **192,920,147** | 140,219,872 |

### 45.1 Analysis

#### 45.1.1 By Product

| | | | | |
|---|---|---|---|---|
| Demand deposits (current accounts) | **4,468,869** | 4,649,369 | **4,468,192** | 4,648,714 |
| Savings deposits | **36,660,313** | 23,798,492 | **36,657,366** | 23,776,214 |
| Fixed deposits | **151,284,299** | 111,052,817 | **150,900,536** | 110,781,249 |
| Certificate of deposits | **477,711** | 739,483 | **477,711** | 739,483 |
| Other deposits | **416,342** | 274,212 | **416,342** | 274,212 |
| | **193,307,534** | 140,514,373 | **192,920,147** | 140,219,872 |

#### 45.1.2 By Currency

| | | | | |
|---|---|---|---|---|
| Sri Lanka Rupee | **151,552,198** | 112,168,697 | **151,172,107** | 111,881,136 |
| United States Dollar (USD) | **37,950,742** | 23,790,651 | **37,943,446** | 23,783,711 |
| Great Britain Pound (GBP) | **1,044,429** | 1,521,875 | **1,044,429** | 1,521,875 |
| Others | **2,760,165** | 3,033,150 | **2,760,165** | 3,033,150 |
| | **193,307,534** | 140,514,373 | **192,920,147** | 140,219,872 |

## 46 Other Borrowing

| | | | | |
|---|---|---|---|---|
| **Repayable in foreign currency** | | | | |
| Borrowing sourced from | | | | |
| Multilateral institutions | **3,281,998** | 3,820,210 | **3,281,998** | 3,820,210 |
| Bilateral institutions | **11,266,708** | 3,995,545 | **11,266,708** | 3,995,545 |
| | **14,548,706** | 7,815,755 | **14,548,706** | 7,815,755 |

| As at | BANK 31.12.2017 LKR 000 | BANK 31.12.2016 LKR 000 | GROUP 31.12.2017 LKR 000 | GROUP 31.12.2016 LKR 000 |
|---|---|---|---|---|
| **Repayable in Rupees** | | | | |
| Borrowing sourced from | | | | |
| Multilateral Institutions | **19,395,507** | 18,536,211 | **19,395,507** | 18,536,211 |
| Bilateral Institutions | **1,369,093** | 1,154,259 | **1,369,093** | 1,154,259 |
| Central Bank of Sri Lanka – refinance loans (secured) | **199,625** | 250,548 | **199,625** | 250,548 |
| Securities sold under repurchase (Repo) agreements | **5,806,660** | 12,994,573 | **5,777,943** | 12,979,527 |
| | **26,770,885** | 32,935,591 | **26,742,168** | 32,920,545 |
| | **41,319,591** | 40,751,346 | **41,290,874** | 40,736,300 |

### *46.1 Assets Pledged as Security*

| *Nature* | **Amount 31.12.2017 LKR 000** |
|---|---|
| Assignment in terms of Section 88 A of the Monetary Law of Loans refinanced by Central Bank | **199,625** |

## 47 Debt Securities Issued

| *Year of Issuance* | Face value LKR 000 | Interest rate % | Repayment terms | Issue date | Maturity date | BANK/GROUP 31.12.2017 LKR 000 | BANK/GROUP 31.12.2016 LKR 000 |
|---|---|---|---|---|---|---|---|
| Issued by Bank | | | | | | | |
| i. Debenture issue (LKR) | | | | | | | |
| – Listed | – | 8.36 | 3 Years | 18 Aug. 14 | 18 Aug. 17 | – | 5,138,232 |
| | 3,000,000 | 9.10 | 5 Years | 10 Jun. 15 | 10 Jun. 20 | **3,136,708** | 3,131,330 |
| | 5,315,450 | 10.63 | 3 Years | 18 Mar. 16 | 18 Mar. 19 | **5,747,779** | 5,745,558 |
| ii. Notes issue (USD) | 15,360,000 | 9.63 | 5 Years | 31 Oct. 13 | 31 Oct. 18 | **15,559,280** | 15,164,065 |
| | 23,675,450 | | | | | **24,443,767** | 29,179,185 |
| Due within one year | | | | | | **15,559,280** | 5,138,232 |
| Due after one year | | | | | | **8,884,487** | 24,040,953 |
| | | | | | | **24,443,767** | 29,179,185 |

Carrying values are the discounted amounts of principal and interest.

## 47.1 Debt Securities Issued – Listed Debentures

| Debenture category | Interest payable frequency | Applicable interest rate % | Interest rate of Comparative Government securites (Gross) p.a. % | Balance as at 31-12-2017 LKR 000 | Market price | | | Yield last traded % |
|---|---|---|---|---|---|---|---|---|
| | | | | | Highest | Lowest | Last traded | |
| **Fixed Rate** | | | | | | | | |
| 2015-2020 | Annually | 9.1 | 9.62 | **3,136,708** | N/T | N/T | N/T | N/A |
| 2016-2019 | Annually | 10.63 | 9.29 | **5,747,779** | N/T | N/T | N/T | N/A |

| Other Ratios | **31.12.2017** | 31.12.2016 |
|---|---|---|
| Debt to equity Ratio | **1.77** | 2.12 |
| Interest cover | **0.99** | 1.01 |
| Liquid asset ratio (%) | **26.8** | 27.2 |

| | BANK | | GROUP | |
|---|---|---|---|---|
| *As at* | **31.12.2017 LKR 000** | 31.12.2016 LKR 000 | **31.12.2017 LKR 000** | 31.12.2016 LKR 000 |
| **48 Other Liabilities** | | | | |
| Accruals | **416,079** | 395,545 | **420,742** | 412,010 |
| Prior year's dividends | **47,318** | 57,538 | **47,318** | 57,538 |
| Security deposit for leases | **4,065** | 4,065 | **81,544** | 44,888 |
| Prepaid loan and lease rentals | **56,836** | 57,166 | **108,980** | 84,442 |
| Account payables | **3,086,110** | 2,925,313 | **3,120,922** | 2,978,449 |
| Provision for staff retirement benefits (Note 48.1) | **330,578** | 282,684 | **352,710** | 306,640 |
| Other provisions (Note 48.2) | **525,412** | 468,364 | **525,412** | 468,364 |
| | **4,466,398** | 4,190,675 | **4,657,628** | 4,352,331 |
| **48.1 Provision for Staff Retirement Benefits** | | | | |
| Defined benefit – unfunded pension (Note 48.1.1) | **61,147** | 61,728 | **61,147** | 61,728 |
| – unfunded end of service gratuity (Note 48.1.2) | **269,431** | 220,956 | **291,563** | 244,912 |
| – funded pension (Note 48.1.3) | | | | |
| | **330,578** | 282,684 | **352,710** | 306,640 |

| | BANK/GROUP | |
|---|---|---|
| *As at* | **2017 LKR 000** | 2016 LKR 000 |
| **48.1.1 Unfunded Pension Liability** | | |
| Balance at beginning | **61,728** | 66,994 |
| Interest on obligation | **5,794** | 5,688 |
| Benefits paid | **(6,995)** | (6,995) |
| Actuarial experience loss | **620** | 608 |
| Actuarial gain due to changes in assumptions | – | (4,567) |
| Present value of defined benefit pension obligations | **61,147** | 61,728 |

| As at | BANK 31.12.2017 LKR 000 | BANK 31.12.2016 LKR 000 | GROUP 31.12.2017 LKR 000 | GROUP 31.12.2016 LKR 000 |
|---|---|---|---|---|
| ***48.1.2 Unfunded End of Service Gratuity*** | | | | |
| Balance at beginning | **220,956** | 180,163 | **244,812** | 206,016 |
| Liability transferred | **2,414** | 3,416 | – | – |
| Current Service cost | **35,041** | 29,417 | **41,507** | 33,853 |
| Interest on obligation | **22,096** | 17,440 | **23,877** | 19,218 |
| Benefits paid | **(20,363)** | (20,488) | **(24,652)** | (22,396) |
| Actuarial experience loss | **9,287** | 11,306 | **6,019** | 8,519 |
| Actuarial gain due to changes in assumptions | – | (298) | – | (298) |
| Present value of defined benefit pension obligations | **269,431** | 220,956 | **291,563** | 244,812 |

| As at | BANK/GROUP 2017 LKR 000 | BANK/GROUP 2016 LKR 000 |
|---|---|---|
| ***48.1.3 Funded Pension Liability/(Asset)*** | | |
| Present value of defined benefit pension obligations (Note 48.1.3.1) | **2,372,248** | 2,280,943 |
| Fair value of pension assets (Note 48.1.3.2) | **(2,554,068)** | (2,446,306) |
| **Defined benefit liability/(asset)** | **(181,820)** | (165,363) |

As per LKAS 19 – "Employee Benefits" if a plan is in surplus, then the amount recognised as an asset in the Statement of Financial Position is limited to the "asset ceiling". The asset ceiling is the present value of any economic benefits available to the entity in the form of a refund or a reduction in future contributions. By analysing all the future economic benefits available to the DFCC Pension Fund, the independent actuary Mr Piyal S Goonetilleke of Priyal S Goonetilleke & Associate has estimated the asset ceiling as at 31 December 2017 to be LKR 287 million in his report dated 13 February 2017.

| As at | BANK/GROUP 2017 LKR 000 | BANK/GROUP 2016 LKR 000 |
|---|---|---|
| ***48.1.3.1 Movement in Defined Pension Obligation*** | | |
| Present value of defined benefit pension obligations at the beginning | **2,280,943** | 2,296,454 |
| Current service cost | **60,496** | 71,746 |
| Interest on obligation | **228,094** | 206,681 |
| Benefits paid | **(197,770)** | (155,931) |
| Actuarial experience loss | **485** | 85,266 |
| Actuarial gain due to changes in assumptions | – | (223,273) |
| Present value of defined benefit pension obligations | **2,372,248** | 2,280,943 |

| As at | BANK/GROUP 2017 LKR 000 | 2016 LKR 000 |
|---|---|---|

### 48.1.3.2 Movement in Pension Assets

| | | |
|---|---|---|
| Pension assets at the beginning | **2,446,306** | 2,237,646 |
| Expected return on pension assets | **233,917** | 193,785 |
| Employer's contribution | **28,823** | 164,000 |
| Benefits paid | **(197,770)** | (155,931) |
| Actuarial experience gain | **42,792** | 6,806 |
| Pension assets | **2,554,068** | 2,446,306 |

### 48.1.3.3 Plan Assets Consist of the following

| | | |
|---|---|---|
| Debentures | **119,184** | 216,555 |
| Government bonds | **231,899** | 1,439,581 |
| Fixed deposits | **2,211,589** | 789,623 |
| Others | **(190,424)** | 547 |
| | **2,372,248** | 2,446,306 |

| As at | Unfunded pension liability* 31.12.2017 LKR 000 | Unfunded end of service gratuity* 31.12.2017 LKR 000 | Funded pension liability* 31.12.2017 LKR 000 |
|---|---|---|---|

### 48.1.3.4. The Expected Benefit Payout in the Future Years to the Defined Benefit Obligation – Bank

| | | | |
|---|---|---|---|
| Within next 12 months | **6,995** | **21,390** | **165,455** |
| Between 2 and 5 years | **27,982** | **143,510** | **784,418** |
| Beyond 5 years | **34,977** | **338,501** | **1,460,791** |

** Based on expected benefits payout in next 10 years*

### 48.1.3.5 Unfunded Pension Liability

This relates to pension liability of an ex-employee, not funded through the DFCC Bank PLC Pension Fund. The liability covers the pension benefit to retiree and survivors.

### 48.1.3.6 Actuarial Valuation

Actuarial valuation was carried out by Mr Piyal S Goonetilleke, Fellow of the Society of Actuaries USA of Priyal S Goonetilleke & Associates, on 31 December 2017.

## 48.1.3.7 Actuarial Valuation Method

Projected unit credit method was used to allocate the actuarial present value of the projected benefits earned by employees to date of valuation.

| | 31 December 2017 | | 31 December 2016 | |
|---|---|---|---|---|
| | **Pension benefit (%)** | **End of service gratuity (%)** | Pension benefit (%) | End of service gratuity (%) |
| ***48.1.3.8 Principal Actuarial Assumptions*** | | | | |
| Discount rate per annum | | | | |
| Pre-retirement | **10** | **10** | 10 | 10 |
| Post-retirement | **10** | **Not applicable** | 10 | Not applicable |
| Future salary increases per annum | **10.5** | **10.5** | 10.5 | 10.5 |
| Expected rate of return on pension assets | **10** | **–** | 10 | – |
| Actual rate of return on pension assets | **11.8** | **–** | 11.8 | – |
| Mortality | **UP 1984 mortality table** | **RP-2000 mortality table** | UP 1984 mortality table | RP-2000 mortality table |
| Retirement age | **55 years** | **55 years** | 55 years | 55 years |
| Normal form of payment: | **Lump sum commuted pension payment followed by reduced pension for 10 years (25% reduction) (for new entrants recovery period is 15 years)** | **Lump sum** | Lump sum commuted pension payment followed by reduced pension for 10 years (25% reduction) (for new entrants recovery period is 15 years) | Lump sum |
| Turnover rate – | | | | |
| Age | | | | |
| 20 | **10.0** | **10.0** | 10.0 | 10.0 |
| 25 | **10.0** | **10.0** | 10.0 | 10.0 |
| 30 | **10.0** | **10.0** | 10.0 | 10.0 |
| 35 | **7.5** | **7.5** | 7.5 | 7.5 |
| 40 | **5.0** | **5.0** | 5.0 | 5.0 |
| 45 | **2.5** | **2.5** | 2.5 | 2.5 |
| 50/55 | **1.0** | **1.0** | 1.0 | 1.0 |

The principle actuarial assumptions in the previous year has not changed. The discount rate is the yield rate on 31 December 2017 with a term equalling the estimated period for which all benefit payments will continue. This period is approximately 22.4 years for pension and 10.6 years for end of service gratuity.

### *48.1.3.9 Principal Actuarial Assumptions – Group*

The subsidiaries have used discount rate of 10.5% and the salary increment rate ranging 6.6% – 8%.

### *48.1.3.10 Sensitivity of Assumptions Used in the Actuarial Valuation*

The following table demonstrates the sensitivity to a reasonably possible change in the key assumptions used with all other variables held constant in the employment benefit liability measurement. The effect in the income statement and the statement of financial position with the assumed changes in the discount rates and salary increment rate is given below:

| | Effect on income statement increase/(decrease) LKR 000 | Effect on defined benefit obligation increase/(decrease) LKR 000 |
|---|---|---|
| **Funded Pension Liability** | | |
| Discount rate | | |
| 1% | 94,927 | (94,927) |
| -1% | (227,378) | 227,378 |
| Salary increment rate | | |
| 1% | (44,561) | 44,561 |
| -1% | 42,054 | (42,054) |
| **Unfunded Pension Liability** | | |
| Discount rate | | |
| 1% | 3,920 | (3,920) |
| -1% | (4,446) | 4,446 |
| **Unfunded End of Service Gratuity *** | | |
| Discount Rate | | |
| 1% | 27,870 | (27,870) |
| -1% | (32,816) | 32,816 |
| Salary increment rate | | |
| 1% | | |
| -1% | (31,626) | 31,626 |
| | 27,439 | (27,439) |

** Salary increment not applicable for ex-employee*

### *48.1.3.11 Historical Information*

| *As at* | 31.12.2016 LKR 000 | 31.12.2015 LKR 000 | 31.03.2015 LKR 000 | 31.03.2014 LKR 000 | 31.03.2013 LKR 000 |
|---|---|---|---|---|---|
| Present value of the defined benefit obligation | 2,280,943 | 2,296,454 | 2,141,648 | 1,866,434 | 1,750,987 |
| Fair value of plan assets | (2,446,306) | (2,237,646) | 2,139,052 | 2,027,664 | 1,821,009 |
| (Surplus)/Deficit in the plan | (165,363) | 58,808 | 2,596 | (161,230) | (70,022) |

| As at | BANK 31.12.2017 LKR 000 | BANK 31.12.2016 LKR 000 | GROUP 31.12.2017 LKR 000 | GROUP 31.12.2016 LKR 000 |
|---|---|---|---|---|
| ***48.2 Other Provisions*** | | | | |
| Balance as at the beginning | **468,364** | 414,702 | **468,364** | 414,702 |
| Provisions for the financial year | **525,412** | 468,364 | **525,412** | 468,364 |
| Provisions used during the year | **(452,256)** | (401,927) | **(452,256)** | (401,927) |
| Provisions reversed during the year | **(16,108)** | (12,775) | **(16,108)** | (12,775) |
| Balance as at 31 December | **525,412** | 468,364 | **525,412** | 468,364 |

## 49 Subordinated Term Debt

| | Face value LKR 000 | Interest rate % | Repayment terms | Issue date | Maturity date | BANK 31.12.2017 LKR 000 | BANK 31.12.2016 LKR 000 | GROUP 31.12.2017 LKR 000 | GROUP 31.12.2016 LKR 000 |
|---|---|---|---|---|---|---|---|---|---|
| Listed Debentures | | | | | | | | | |
| Issued by Bank | 6,043,140 | 12.75 | 7 years | 9-Nov-16 | 9-Nov-23 | **6,129,480** | 6,131,261 | **6,129,480** | 6,131,261 |
| | 956,860 | 12.15 | 5 years | 9-Nov-16 | 9-Nov-21 | **970,023** | 970,094 | **970,023** | 970,094 |
| Transferred on amalgamation | 2,000,000 | 9.4 | 5 years | 10-Jun-15 | 10-Jun-20 | **2,103,367** | 2,104,282 | **2,103,367** | 2,104,282 |
| | 9,000,000 | | | | | **9,202,870** | 9,205,637 | **9,202,870** | 9,205,637 |
| Due after one year | | | | | | **9,202,870** | 9,205,637 | **9,202,870** | 9,205,637 |
| | | | | | | **9,202,870** | 9,205,637 | **9,202,870** | 9,205,637 |

### 49.1 Subordinated Term Debt – Listed Debentures

| Debenture category | Interest rate frequency | Applicable interest rate % | Interest rate of comparative government securities (Gross) p.a % | Balance as at 31.12.2017 LKR 000 | Market price Highest | Market price Lowest | Market price Last traded | Yield last traded % |
|---|---|---|---|---|---|---|---|---|
| **Fixed Rate** | | | | | | | | |
| 2015-2020 | Annually | 9.4 | 9.62 | **2,103,367** | N/T | N/T | N/T | N/A |
| 2016-2021 | Annually | 12.15 | 9.75 | **970,023** | N/T | N/T | N/T | N/A |
| 2016-2023 | Annually | 12.75 | 10.01 | **6,129,480** | 100.5 | 100 | 100 | 12.71 |
| | | | | **9,202,870** | | | | |

N/T – Not traded
Debt equity ratio, interest cover and liquid asset ratio is given in note 47.1.

| As at | BANK/GROUP 31.12.2017 LKR 000 | BANK/GROUP 31.12.2016 LKR 000 |
|---|---|---|
| **50 Stated Capital** | | |
| Balance as at 31 December (Number of shares – 265,097,688) | **4,715,814** | 4,715,814 |

## 51 Statutory Reserves

### 51.1 Reserve Fund

Five per cent of profit after tax is transferred to the reserve fund as per Direction issued by Central Bank of Sri Lanka under Section 76 (j) (1) of the Banking Act No. 30 of 1988 as amended by Banking (Amendment) Act No. 33 of 1995.

## 52 Retained Earnings

This represents cumulative net earnings, inclusive of final dividend approved amounting to LKR 1,325 million. The balance is retained and reinvested in the business of the bank.

| | BANK | | GROUP | |
|---|---|---|---|---|
| *As at* | **31.12.2017 LKR 000** | 31.12.2016 LKR 000 | **31.12.2017 LKR 000** | 31.12.2016 LKR 000 |
| **53 Other Reserves** | | | | |
| General reserve | **13,779,839** | 13,779,839 | **13,779,839** | 13,779,839 |
| Fair value reserve | **13,298,686** | 14,549,487 | **11,032,483** | 12,085,454 |
| Exchange equalisation reserve | **–** | – | **13,061** | 33,428 |
| | **27,078,525** | 28,329,326 | **24,825,383** | 25,898,721 |

## 54 Commitments and Contingencies

**Accounting Policy →**

**Commitments and Contingencies**

*Contingent liabilities, which include guarantees are possible obligations that arise from past events whose existence will be confirmed only by the occurrence, or non-occurrence, of one or more uncertain future events not wholly within the control of the Bank; or are present obligations that have arisen from past events but are not recognised because it is not probable that settlement will require the outflow of economic benefits, or because the amount of the obligations cannot be reliably measured. Contingent liabilities are not recognised in the financial statements but are disclosed unless the probability of settlement is remote.*

**Financial Guarantees**

*Liabilities under financial guarantee contracts are recorded initially at their fair value, which is generally the fee received or receivable. Subsequently, financial guarantee liabilities are measured at the higher of the initial fair value, less cumulative amortisation, and the best estimate of the expenditure required to settle the obligations.*

| As at | BANK | | GROUP | |
|---|---|---|---|---|
| | **31.12.2017 LKR 000** | 31.12.2016 LKR 000 | **31.12.2017 LKR 000** | 31.12.2016 LKR 000 |

## *54.1 Commitments and Contingencies*

| | | | | |
|---|---|---|---|---|
| Guarantees issued to – | | | | |
| Banks in respect of indebtedness of customers of the Bank | **135,464** | 34,403 | **135,464** | 34,403 |
| Companies in respect of indebtedness of customers of the Bank | **9,297,340** | 5,092,952 | **9,297,340** | 5,092,952 |
| Principal collector of customs (duty guarantees) | **276,587** | 313,295 | **276,587** | 313,295 |
| Shipping guarantees | **2,939,459** | 1,541,757 | **2,939,459** | 1,541,757 |
| Documentary credit | **15,098,107** | 9,763,476 | **15,098,107** | 9,763,476 |
| Bills for collection | **2,305,466** | 3,148,059 | **2,305,466** | 3,148,059 |
| Performance bonds | **3,922,424** | 2,461,709 | **3,922,424** | 2,461,709 |
| Forward exchange contracts (net) | **38,118,013** | 26,704,132 | **38,118,013** | 26,704,132 |
| Commitments in ordinary course of business – Commitments for unutilised credit facilities | **62,852,575** | 52,059,192 | **62,852,575** | 52,059,192 |
| Capital expenditure approved by the Board of Directors | | | | |
| Contracted | **288,635** | 202,692 | **288,635** | 202,692 |
| Not contracted | **337,254** | 130,434 | **337,254** | 130,434 |
| | **135,571,324** | 101,452,101 | **135,571,324** | 101,452,101 |

## *54.2 Litigation Against the Bank*

***54.2.1*** A client has filed action against five defendants including the Bank in the District Court of Kurunegala, claiming that a property mortgaged by him to the Bank had been unlawfully transferred to a third party under the parate process to be set aside, and also claiming LKR 6 million as damages from the Bank. The Bank is defending the case before the District Court.

***54.2.2*** There are four cases filed in the District Court of Kandy and one case filed in the District Court of Negombo and another case in the District Court of Moratuwa, where third parties are claiming ownership of properties acquired by the Bank under recovery action. The Bank is defending the cases before the respective District Courts.

***54.2.3*** There is one cases filed in the District Court of Bandarawela, where a third party is claiming ownership of a property mortgaged to the Bank. The Bank is defending the cases before the respective District Court.

***54.2.4*** There are two cases filed in the District Court of Anuradhapura, by a customer claiming damages due to a cancellation by the insurer of an insurance policy covering a mortgaged asset and claiming damages for not insuring a mortgaged asset. The Bank is defending the cases before the District Court.

***54.2.5*** There is one case filed in the District Court of Theldeniya, where a third party is claiming ownership of a property mortgaged to the Bank. The Bank is defending the case before the District Court of Theldeniya.

***54.2.6*** A client has filed a case in the District Court of Matara claiming damages from the Bank claiming that as the loan was not disbursed in lump sum but in instalments bases on the client's progress as such his business went into decline and he suffered losses. The Bank is defending the case before the District Court of Matara.

***54.2.7*** The Bank has appealed to the High Court to set aside an award made in favour of an ex-employee by the Labour Tribunal.

***54.2.8*** Case filed in the Labour Tribunal by one ex-employee of the Bank, claiming compensation from the Bank.

***54.2.9*** Case filed in the Labour Tribunal – Galle by an ex-employee of the Bank, claiming compensation and reinstatement from the Bank.

No material losses are anticipated as a result of the aforesaid actions.

### 54.3 Tax Assessments Against the Bank

The following assessments are outstanding, against which the Bank has duly appealed.

1. The income tax assessment received by the Bank for the Year of Assessment 2010/11, which was determined by the Commissioner General of Inland Revenue amounting to LKR 760 million has been appealed to the Tax Appeal Commission for their determination.
2. Tax assessments received by the Bank on Value Added Tax for quarters ending 31.03.2016, 30.06.2016 and 30.09.2016, charging a penalty of LKR 2.8 million, due to differences in records of the Department of Inland Revenue. The bank has paid all the taxes on due dates and accordingly has appealed against these assessments.

The Bank is of the view that the above assessments will not have any significant impact on the financial statements.

## 55 Related Party Transactions

**55.1** The Group's related parties include associates, subsidiaries, Trust established by the Bank for post-employment retirement plan, joint venture, Key Management Personnel, close family members of Key Management Personnel and entities which are controlled, jointly controlled or significantly influenced for which significant voting power is held by Key Management Personnel or their close family members.

### 55.2 Parent and Ultimate Controlling Party

The Bank does not have an identifiable parent of its own.

| *As at* | **31.12.2017 LKR 000** | 31.12.2016 LKR 000 |
|---|---|---|
| **55.3 Transactions with Subsidiaries** | | |
| **55.3.1 Statement of Financial Position – Bank** | | |
| **Liabilities** | | |
| Due to other customers | **380,431** | 290,777 |
| Other borrowings | **28,058** | 15,065 |
| | **408,489** | 305,842 |

| *Year ended 31 December* | **2017 LKR 000** | 2016 LKR 000 |
|---|---|---|
| **55.3.2 Income Statement – Bank** | | |
| Interest income | **23** | 20 |
| Interest expense | **45,710** | 29,930 |
| Fee and commission income | **33** | 44 |
| Other operating income (net) | **413** | 317 |
| Net gain from financial investments – dividend received | **51,466** | 44,596 |
| Other overhead expenses net of reimbursements | **106,067** | 125,412 |
| **55.3.3 Other Transactions – Bank** | | |
| Payments made for purchase of computer software | **43,782** | 31,134 |

| As at | 31.12.2017 LKR 000 | 31.12.2016 LKR 000 |
|---|---|---|

## 55.4 Transactions with Joint Venture

### 55.4.1 Statement of Financial Position – Bank

| | | |
|---|---|---|
| **Assets** | | |
| Loans to and receivable from other customers | **127,522** | 146,271 |
| | **127,522** | 146,271 |
| **Liabilities** | | |
| Due to other customers | **442** | 1,506 |
| Debt securities issued | **–** | 103 |
| | **442** | 1,609 |

| Year ended 31 December | 2017 LKR 000 | 2016 LKR 000 |
|---|---|---|

### 55.4.2 Income Statement – Bank

| | | |
|---|---|---|
| Interest income | **18,258** | – |
| Interest expenses | **–** | 8 |
| Fee and commission income | **1** | – |
| Net Gain from financial investments – dividend received | **33,220** | 30,200 |

| As at | 31.12.2017 LKR 000 | 31.12.2016 LKR 000 |
|---|---|---|

## 55.5 Transactions with Associate

### 55.5.1 Statement of Financial Position-Bank

| | | |
|---|---|---|
| **Liabilities** | | |
| Due to other customers | **306** | 135 |
| | **306** | 135 |

| Year ended 31 December | 2017 LKR 000 | 2016 LKR 000 |
|---|---|---|

### 55.5.2 Income Statement – Bank

| | | |
|---|---|---|
| Fee and commission income | **15** | – |
| Net gain from financial investments – dividend received | **6,777** | 9,463 |

| *As at* | 31.12.2017 LKR 000 | 31.12.2016 LKR 000 |
|---|---|---|

## 55.6 Transaction with Entities in which Directors of the Bank have Significant Influence

### 55.6.1 Statement of Financial Position – Bank

| *As at* | **31.12.2017 LKR 000** | 31.12.2016 LKR 000 |
|---|---|---|
| **Assets** | | |
| Loans to and receivables from other customers | **63,803** | – |
| | **63,803** | – |
| **Liabilities** | | |
| Due to other Customers | **1,158** | – |
| | **1,158** | – |

### 55.6.2 Income Statement – Bank

| *Year ended 31 December* | **2017 LKR 000** | 2016 LKR 000 |
|---|---|---|
| Interest income | **250** | – |
| Interest expenses | **11** | – |
| Fee and commission income | **973** | – |
| Other overhead expense | **30** | – |

## 55.7 Transactions with Key Management Personnel

### 55.7.1 Key Management Personnel

Key Management Personnel are the Board of Directors of the Bank including Chief Executive, Deputy Chief Executive, Executive Vice President Strategic Planning and Subsidiaries, Chief Risk Officer, Chief Financial Officer, Chief Operating Officer, and Senior Vice President Treasury and Resource Mobilisation for the purpose of Sri Lanka Accounting Standard – LKAS 24 on “Related Party Disclosures”.

### 55.7.2 Compensation of Directors and Other Key Management Personnel

| | | BANK | | GROUP | |
|---|---|---|---|---|---|
| | | **Year ended 31.12.2017 LKR 000** | Year ended 31.12.2016 LKR 000 | **Year ended 31.12.2017 LKR 000** | Year ended 31.12.2016 LKR 000 |
| Number of persons | | **14** | 16 | **16** | 18 |
| Short-term employment benefits | | **139,434** | 124,920 | **155,950** | 139,575 |
| Post-employment benefits | – Pension | **1,931** | 2,494 | **1,931** | 2,494 |
| | – Others | **17,528** | 15,115 | **17,983** | 15,524 |
| | | **158,893** | 142,529 | **175,864** | 157,593 |

| As at | 31.12.2017 | | 31.12.2016 | |
|---|---|---|---|---|
| | Number of KMPs | LKR 000 | Number of KMPs | LKR 000 |

### 55.7.3 Other Transactions with Key Management Personnel and their Close Family Members

#### 55.7.3.1 Statement of Financial Position – Bank

| | Number of KMPs 2017 | LKR 000 2017 | Number of KMPs 2016 | LKR 000 2016 |
|---|---|---|---|---|
| **Assets** | | | | |
| Loans to and receivables from other customers | **4** | **22,994** | 6 | 17,289 |
| **Liabilities** | | | | |
| Due to other customers | **18** | **270,569** | 21 | 285,106 |
| Other borrowings | **1** | **32,489** | 1 | 16,400 |
| Debt securities issued | **1** | **2,168** | 1 | 2,168 |
| | | **305,226** | | 303,674 |

| | Year ended 31.12.2017 LKR 000 | Year ended 31.12.2016 LKR 000 |
|---|---|---|

#### 55.7.3.2 Income Statement – Bank

| | Year ended 31.12.2017 LKR 000 | Year ended 31.12.2016 LKR 000 |
|---|---|---|
| Interest income | **1,265** | 877 |
| Interest expense | **30,575** | 20,405 |
| Fee and commission income | **5** | 5 |

### 55.7.4 Accommodation Granted to Directors of the Bank

Disclosure under Section 47 (11A) of the Banking Act, No. 30 of 1988 as amended by Amendment Act No. 2 of 2005

| Name of Director | Limit LKR 000 | Type of Facility | Balance as at 31.12.2017 LKR 000 |
|---|---|---|---|
| C R Jansz | 500 | Credit Card | – |
| L H A L Silva | 500 | Credit Card | – |
| S R Thambiayah | 500 | Credit Card | – |
| | | | – |

### 55.7.5 Transactions with DFCC Bank Pension Fund – Trust

DFCC Bank Pension Fund constituted as a Trust was established by the DFCC Bank to discharge defined benefit pension liability of eligible employees of the Bank.

| | 31.12.2017 LKR 000 | 31.12.2016 LKR 000 |
|---|---|---|
| Contribution prepaid/(payable) as at beginning | **165,363** | (58,808) |
| Contribution due for the financial year recognised as expense in income statement | **(54,673)** | (84,642) |
| Recognition of actuarial gains in the other comprehensive income | **42,307** | 144,813 |
| Contribution paid by the Bank | **28,823** | 164,000 |
| Contribution prepaid (Note 48.1.3) | **181,820** | 165,363 |

## *55.8 Transactions with Government of Sri Lanka (GOSL) and its Related Entities*

Entities related to the Government of Sri Lanka (GOSL) by virtue of their aggregate shareholdings has the power to participate in the financial and operating policy decision of the Bank and by extension to participate in the financial and operating policy decisions of the Bank. However, in fact this power was not exercised.

Paragraph 25 of Sri Lanka Accounting Standard Related Party Disclosure – LKAS 24 has exempted DFCC Bank from the normally applicable disclosure requirements on transactions with GOSL – related entities. In making use of this exemption the Board has determined that the limited disclosure required under paragraph 26 of LKAS 24 is only required to be made for transaction that are individually significant because of their size although these transactions were undertaken on normal market terms in the ordinary course of business and there was no requirement to disclose the transactions to regulatory or supervisory authorities or require shareholder approval.

### *55.8.1 Individually Significant Transactions Included in the Statement of Financial Position*

| *As at* | **31.12.2017 LKR 000** | 31.12.2016 LKR 000 |
|---|---|---|
| ***55.8.1.1 Statement of Financial Position – Bank*** | | |
| **Assets** | | |
| Balances with Central Bank of Sri Lanka | **10,557,688** | 8,062,567 |
| Placements with banks | **100,060** | – |
| Loans to and receivables from banks | **10,956,289** | 12,213,311 |
| Loans to and receivables from other customers | **7,130,529** | 5,859,992 |
| Other financial assets held for trading | **279,094** | – |
| Financial investments – held to maturity | **18,376,228** | 17,239,338 |
| Financial investments available for sale | **37,746,039** | 29,365,255 |
| Government grant receivable | **642,582** | 861,914 |
| | **85,788,509** | 73,602,377 |
| **Liabilities** | | |
| Due to Banks | **7,315,012** | 7,672,071 |
| Due to other customers | **3,952,692** | 5,796,290 |
| Other borrowing | – | 8,388,916 |
| Other borrowing – credit lines | **23,351,882** | 23,761,357 |
| Debt securities issued | **2,138,927** | 2,393,335 |
| Government grant deferred income | **654,582** | 701,664 |
| Subordinated term debt | **3,528,506** | 3,004,003 |
| | **40,941,601** | 51,717,636 |
| **Commitments** | | |
| Undrawn credit facilities | **8,740,754** | 3,494,485 |

| | **Year ended 31.12.2017 LKR 000** | Year ended 31.12.2016 LKR 000 |
|---|---|---|
| ***55.8.1.2 Income Statement – Bank*** | | |
| Interest income | **6,418,084** | 3,454,367 |
| Net gain/(loss) from trading | **2,231** | (9,880) |
| Interest expense | **3,156,669** | 3,050,930 |

There are no other transactions that are collectively significant with Government-related entities.

## 55.9 Disclosure Requirement under Section 9.3.2 (a) and 9.3.2 (b) of the CSE Listing Rules

As per rule No. 9.3.2 (a) the Bank does not have any non-recurrent related party transactions carried out during the financial year under review with a value exceeding 10% of the equity or 5% of the total assets whichever is lower, as per the audited financial statements of the Bank.

As per rule No. 9.3.2 (b) the Bank has following recurrent related party transactions carried out during the financial year under review with value exceeding 10% of the gross revenue/income as per the latest audited financial statements of the bank.

| Name of the related party | Relationship | Nature of the transaction | Aggregate value of related party transactions entered into during the financial year | Aggregate value of related party transactions as a % of net revenue/income | Terms and conditions of the related party transactions |
|---|---|---|---|---|---|
| Entities related to the Government of Sri Lanka | Related party | On Balance Sheet and off Balance Sheet credit facility | Facilities approved during the year LKR 6,691.5 million | 0.83%* | Terms and conditions under normal commercial terms similar to other non-related customers |

**Actual income on the facilities disbursed and the projected annual income on the facilities offered not disbursed as a percentage of the total annual consolidated income of the Bank.*

## 55.10 Pricing Policy and Terms for Transactions with Related Parties

Bank enters into transactions with related parties in the ordinary course of business on terms similar to comparable transactions with an unrelated comparable counterparty with the exception of accommodation granted to Key Management Personnel under approved schemes uniformly applicable to all or specific categories of employees. The terms include pricing for loans, deposits and services, collateral obtained for loans where appropriate.

## 56 Business Segment Information

Business segment results include items directly attributable to a business segment as well as those that can be allocated on a reasonable basis. Unallocated items include corporate assets, head office expenses and tax assets and liabilities.

| *For the period ended 31 December 2017* | Banking LKR 000 | Finance leasing LKR 000 | Investing in equity LKR 000 | Other LKR 000 | Unallocated LKR 000 | Eliminations LKR 000 | Total LKR 000 |
|---|---|---|---|---|---|---|---|
| **Group** | | | | | | | |
| **Revenue** | | | | | | | |
| Interest income | 30,912,425 | 2,074,165 | – | 54,654 | – | (46,608) | 32,994,636 |
| Net fee and commission income | 1,591,336 | – | – | 607 | – | – | 1,591,943 |
| Net gain from trading | 361,647 | – | – | – | – | – | 361,647 |
| Net loss from financial instruments at fair value through profit or loss | (404,586) | – | – | – | – | – | (404,586) |
| Net gain from financial investments | 197,915 | – | 2,040,251 | – | – | (293,048) | 1,945,118 |
| Other operating (loss)/income – net | (831,541) | – | – | 497,772 | – | (167,898) | (501,667) |
| **Total income** | 31,827,196 | 2,074,165 | 2,040,251 | 553,033 | – | (507,554) | 35,987,091 |
| **Percentage*** | 88 | 6 | 5 | 2 | – | (1) | 100 |

| For the period ended 31 December 2017 | Banking LKR 000 | Finance leasing LKR 000 | Investing in equity LKR 000 | Other LKR 000 | Unallocated LKR 000 | Eliminations LKR 000 | Total LKR 000 |
|---|---|---|---|---|---|---|---|
| **Expenses** | | | | | | | |
| Segment losses | 1,121,003 | 32,598 | 22,811 | 3,850 | – | (9,896) | 1,170,366 |
| Depreciation | – | – | – | 41,836 | – | – | 41,836 |
| Other operating and interest expense | 24,782,926 | 1,591,944 | – | 326,677 | – | (231,054) | 26,470,493 |
| | 25,903,929 | 1,624,542 | 22,811 | 372,363 | – | (240,950) | 27,682,695 |
| **Result** | 5,923,267 | 449,623 | 2,017,440 | 180,670 | – | (266,604) | 8,304,396 |
| Unallocated expenses | | | | | | | 1,139,267 |
| Value added tax and nation building tax on financial services | | | | | | | 1,458,749 |
| Operating profit after value added tax and nation building tax on financial services | | | | | | | 5,706,380 |
| Share of profits of associate and joint venture | | | | | | | 185,030 |
| **Profit before income tax** | | | | | | | 5,891,410 |
| Income tax expense | | | | | | | 1,457,653 |
| **Profit for the year** | | | | | | | 4,433,757 |
| **Other comprehensive expenses net of tax** | | | | | | | (1,032,435) |
| **Total comprehensive income** | | | | | | | 3,401,322 |
| Total comprehensive income – non-controlling interests | | | | | | | 71,572 |
| **Profit attributable to equity holders of the Bank** | | | | | | | 3,329,750 |
| **Assets** | 269,505,984 | 16,493,374 | 19,201,495 | 915,651 | 27,271,249 | (603,868) | 332,783,885 |
| Percentage* | 81 | 5 | 6 | – | 8 | – | 100 |
| Investments in associate and joint venture company | | | | | | | 1,683,977 |
| **Liabilities** | 242,555,385 | 14,844,037 | – | 258,360 | 27,845,355 | (437,132) | 285,066,005 |
| Capital expenditure – additions | – | – | – | 10,015 | 605,297 | – | 615,312 |

* *Net of eliminations.*

| For the period ended 31 December 2016 | Banking LKR 000 | Finance leasing LKR 000 | Investing in equity LKR 000 | Other LKR 000 | Unallocated LKR 000 | Eliminations LKR 000 | Total LKR 000 |
|---|---|---|---|---|---|---|---|
| **Group** | | | | | | | |
| **Revenue** | | | | | | | |
| Interest income | 22,360,944 | 1,833,214 | – | 42,070 | – | (30,116) | 24,206,112 |
| Net fee and commission income | 1,309,049 | – | – | | – | | 1,309,049 |
| Net gain from trading | 340,456 | – | – | – | – | – | 340,456 |
| Net loss from financial instruments at fair value through profit or loss | (179,727) | – | – | – | – | – | (179,727) |
| Net gain from financial investments | 152,695 | – | 1,012,694 | – | – | (84,260) | 1,081,129 |
| Other operating (loss)/Income – net | (125,553) | – | – | 469,396 | 50,123 | (170,902) | 223,064 |
| **Total income** | 23,857,864 | 1,833,214 | 1,012,694 | 511,466 | 50,123 | (285,278) | 26,980,083 |
| **Percentage*** | 88 | 7 | 4 | 2 | – | (1) | 100 |
| **Expenses** | | | | | | | |
| Segment losses | 882,415 | – | 54,852 | – | – | (20,923) | 916,344 |
| Depreciation | – | – | – | 38,254 | – | – | 38,254 |
| Other operating and interest expense | 18,399,506 | 1,300,127 | – | 310,902 | – | (201,532) | 19,809,003 |
| | 19,281,921 | 1,300,127 | 54,852 | 349,156 | – | (222,455) | 20,763,601 |
| Result | 4,575,943 | 533,087 | 957,842 | 162,310 | 50,123 | (62,823) | 6,216,482 |
| Unallocated expenses | | | | | | | 717,355 |
| Value added tax and nation building tax on financial services | | | | | | | 986,110 |
| Operating profit after value added tax and nation building tax on financial services | | | | | | | 4,513,017 |
| Share of profits of associate and joint venture | | | | | | | 161,151 |
| **Profit before income tax** | | | | | | | 4,674,168 |
| Income tax expense | | | | | | | 1,205,094 |
| **Profit for the year** | | | | | | | 3,469,074 |
| **Other comprehensive expenses net of tax** | | | | | | | 382,670 |
| **Total comprehensive income** | | | | | | | 3,851,744 |
| Total comprehensive income – non-controlling interests | | | | | | | 54,270 |
| **Profit attributable to equity holders of the Bank** | | | | | | | 3,797,474 |
| **Assets** | 236,081,685 | 15,909,152 | 20,018,918 | 790,936 | 17,416,817 | (446,216) | 289,771,292 |
| Percentage* | 81 | 5 | 7 | 1 | 6 | – | 100 |
| Investments in associate and joint venture company | | | | | | | 1,443,127 |
| **Liabilities** | 212,473,516 | 14,318,237 | – | 228,080 | 17,470,595 | (334,584) | 244,155,844 |
| Capital expenditure – additions | – | – | – | 39,942 | 218,550 | – | 258,492 |

* *Net of eliminations.*

***56.1*** Revenue and expenses attributable to the incorporated business segments of industrial estate management, information technology services and consultancy services are included in the column for other.

***56.2*** Property and equipment and depreciation attributable to an incorporated business segment is included in the relevant segment and the balance is unallocated.

***56.3*** Eliminations are the consolidation adjustments for inter-company transactions, dividend and dividend payable attributable to minority shareholders.

## 57 Comparative Figures

### 57.1 Reclassification of Comparative figures

The following information has been reclassified with the current year's classification in order to provide a better presentation.

| | Current presentation | | As disclosed previously | |
|---|---|---|---|---|
| | Bank LKR 000 | Group LKR 000 | Bank LKR 000 | Group LKR 000 |
| Prepayments | – | – | 53,803 | 53,803 |
| Other assets | 2,730,999 | 2,777,676 | 2,728,340 | 2,775,017 |
| Other borrowing | 40,751,346 | 40,756,300 | 40,802,490 | 40,807,444 |

## 58 Events after the Reporting Period

### 58.1 First and Final Dividend

The Directors have approved the payment of a first and final dividend of LKR 5.00 per share for the year ended 31 December 2017. The Board of Directors confirms that the Bank has satisfied the solvency test in accordance with Section 57 of the Companies Act, No. 07 of 2007 and has obtained the certificate from the Auditors.

### 58.2 Proposed Debenture Issue

The Bank will issue fifty million (50,000,000) Basel III compliant, subordinated,listed, rated, unsecured, redeemable debentures with a non-viability conversion option, each at an issue price (par value) of LKR 100.00 with a term up to 7 years ("Debentures"), with an option to issue a further twenty million (20,000,000) of said Debentures in the event of an over subscription. After regulatory approvals, the resolution was taken up at the Extraordinary General Meeting held on 19 February 2018, and was approved by the shareholders.

No other circumstances have arisen which would require disclosure or adjustment to the financial statements.

## 59 Fair Value Measurement

### 59.1 Determining Fair Value

The determination of fair value for financial assets and financial liabilities, for which there is no observable market price, requires the use of valuation techniques as described in Note 5.3.5. For financial instruments that trade infrequently and have little price transparency, fair value is less objective and requires varying degrees of judgment depending on liquidity, concentration, uncertainty of market factors, pricing assumptions and other risks affecting the specific instrument. The Group's accounting policy on fair value measurements is discussed in Note 5.3.5. The Group measures fair values, using the following fair value hierarchy that reflects the significance of the inputs used in making the measurements.

**Level 1:** Quoted market price (unadjusted) in an active market for an identical instrument.

**Level 2:** Valuation techniques based on observable inputs, either directly (i.e., prices) or indirectly (i.e., derived from prices).

This category includes instruments valued using quoted market prices in active markets for similar instruments, quoted prices for identical or similar instruments in markets that are considered less than active or other valuation techniques where all significant inputs are directly or indirectly observable from market data.

**Level 3:** Valuation techniques using significant unobservable inputs. This category includes all instruments where the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued, based on quoted prices for similar instruments where significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

The Group uses widely recognised valuation models for determining the fair value of common and more simple financial instruments, like government securities, interest rate and currency swaps that use mostly observable market data and require little Management judgement and estimation. Observable prices and model inputs are usually available in the market for listed debt and equity securities, government securities and simple over the counter derivatives like forward exchange contracts and interest rate swaps. Availability of observable market prices and model inputs reduces the need for management judgement and estimation and also reduces the uncertainty associated with determination of fair values. Availability of observable market prices and inputs varies depending on the products and markets and is prone to changes based on specific events and general conditions in the financial markets.

Management judgements and estimations are usually required for selection of the appropriate valuation model to be used, determination of expected future cash flows on the financial instrument being valued, determination of probability of counterparty default and prepayments and selection of appropriate discount rates.

### 59.2 Valuation Framework

The established control framework with respect to the measurement of fair values, includes an oversight which is independent of front office management. Treasury Middle Office has overall responsibility for independently verifying the results of trading and investment operation.

Specific controls include:

- Verification of observable pricing
- Review and approval process for new models and changes to models involving both product control and group market risk
- Calibration and back testing of models
- Stress Testing

When third party information, such as broker quotes or pricing services is used to measure fair value, the evidence so obtained to support the conclusion that such valuations meet the requirements of SLFRSs/LKASs is documented.

This includes:

- Verifying that the broker or pricing service is approved by the Bank for use in pricing the relevant type of financial instrument
- Several quotes obtained from randomly selected brokers for the same financial instrument and the fair value determined on this basis

Any changes to the fair value methodology is reported to the Bank's Audit Committee.

## *59.3 Fair Value by Level of the Fair Value Hierarchy – Bank*

| *As at 31 December 2017* | Notes | Level 1 LKR 000 | Level 2 LKR 000 | Level 3 LKR 000 | Total LKR 000 |
|---|---|---|---|---|---|
| **Financial Assets** | | | | | |
| Derivative assets held-for-risk management | 27 | | | | |
| Forward foreign exchange contracts | | – | 66,440 | – | 66,440 |
| Other financial assets held for trading | 28 | | | | |
| Government of Sri Lanka Treasury Bills and Bonds | | 279,098 | – | – | 279,098 |
| Equity securities | | 31,828 | – | – | 31,828 |
| Financial investments – Available for sale | 31 | | | | |
| Government of Sri Lanka Treasury Bills and Bonds | | 37,746,039 | – | – | 37,746,039 |
| Quoted ordinary shares | | 18,195,008 | – | – | 18,195,008 |
| Units in Unit Trusts – Quoted | | 194,590 | – | – | 194,590 |
| Units in Unit Trusts – Unquoted | | – | 644,862 | – | 644,862 |
| Unquoted shares | | – | – | 85,555 | 85,555 |
| Government grant receivable | 41 | – | 642,583 | – | 642,583 |
| | | 56,446,563 | 1,353,885 | 85,555 | 57,886,003 |
| **Financial Liabilities** | | | | | |
| Derivative liabilities held-for-risk management | 28 | | | | |
| Forward foreign exchange contracts | | – | 367,435 | – | 367,435 |
| | | – | 367,435 | – | 367,435 |

| As at 31 December 2016 | Notes | Level 1 LKR 000 | Level 2 LKR 000 | Level 3 LKR 000 | Total LKR 000 |
|---|---|---|---|---|---|
| **Financial Assets** | | | | | |
| Derivative assets held-for-risk management | 27 | | | | |
| Forward foreign exchange contracts | | – | 122,977 | – | 122,977 |
| Financial investments – Available for sale | 31 | | | | |
| Government of Sri Lanka Treasury Bills and Bonds | | 29,365,255 | – | – | 29,365,255 |
| Quoted ordinary shares | | 18,797,640 | – | – | 18,797,639 |
| Units in Unit Trusts – Quoted | | 190,153 | – | – | 190,153 |
| Units in Unit Trusts – Unquoted | | – | 806,211 | – | 806,211 |
| Unquoted shares | | – | – | 112,984 | 112,984 |
| Government grant receivable | 41 | – | 861,915 | – | 861,915 |
| | | 48,353,048 | 1,791,103 | 112,984 | 50,257,135 |
| **Financial Liabilities** | | | | | |
| Derivative liabilities held-for-risk management | 28 | | | | |
| Forward foreign exchange contracts | | – | 105,741 | – | 105,741 |
| | | – | 105,741 | – | 105,741 |

As Treasury Bills/Bonds are valued using Central Bank published rates, investments in Treasury Bills/Bonds are classified under Level 1.

## *59.4 Fair Value by Level of the Fair Value Hierarchy – Group*

| As at 31 December 2017 | Notes | Level 1 LKR 000 | Level 2 LKR 000 | Level 3 LKR 000 | Total LKR 000 |
|---|---|---|---|---|---|
| **Financial Assets** | | | | | |
| Derivative assets held-for-risk management | 27 | | | | |
| Forward foreign exchange contracts | | – | 66,440 | – | 66,440 |
| Other financial assets held-for-trading | 28 | | | | |
| Government of Sri Lanka Treasury Bonds | | 279,098 | – | – | 279,098 |
| Equity securities – Quoted | | 31,828 | – | – | 31,828 |
| Financial investments – Available for sale | 31 | | | | |
| Government of Sri Lanka Treasury Bills and Bonds | | 37,746,039 | – | – | 37,746,039 |
| Quoted ordinary shares | | 18,195,008 | – | – | 18,195,008 |
| Units in Unit Trusts – Quoted | | 194,590 | – | – | 194,590 |
| Units in Unit Trusts – Unquoted | | – | 644,862 | – | 644,862 |
| Unquoted shares | | – | – | 85,555 | 85,555 |
| Government grant receivable | 41 | – | 642,583 | – | 642,583 |
| | | 56,446,563 | 1,353,885 | 85,555 | 57,886,003 |
| **Financial Liabilities** | | | | | |
| Derivative liabilities held-for-risk management | 28 | | | | |
| Forward foreign exchange contracts | | – | 367,435 | – | 367,435 |
| | | – | 367,435 | – | 367,435 |

| As at 31 December 2016 | Notes | Level 1 LKR 000 | Level 2 LKR 000 | Level 3 LKR 000 | Total LKR 000 |
|---|---|---|---|---|---|
| **Financial Assets** | | | | | |
| Derivative assets held-for-risk management | 27 | | | | |
| Forward foreign exchange contracts | | – | 122,977 | – | 122,977 |
| Financial investments – Available for sale | 31 | | | | |
| Government of Sri Lanka Treasury Bills and Bonds | | 29,365,255 | – | – | 29,365,255 |
| Quoted ordinary shares | | 18,797,640 | – | – | 18,797,640 |
| Units in Unit Trusts – Quoted | | 190,153 | – | – | 190,153 |
| Units in Unit Trusts – Unquoted | | – | 806,211 | – | 806,211 |
| Unquoted shares | | – | – | 112,984 | 112,984 |
| Government grant receivable | 41 | – | 861,915 | – | 861,915 |
| | | 48,353,048 | 1,791,103 | 112,984 | 50,257,135 |
| **Financial Liabilities** | | | | | |
| Derivative liabilities held-for-risk management | 28 | | | | |
| Forward foreign exchange contracts | | – | 105,741 | – | 105,741 |
| | | – | 105,741 | – | 105,741 |

## *59.5 Fair Value of Financial Instruments Carried at Amortised Cost – Bank*

The following table summarises the carrying amounts and the Bank's estimate of fair values of those financial assets and liabilities not presented on the Bank's statement of financial position at fair value. The fair values in the table below may be different from the actual amounts that will be received/paid on the settlement or maturity of the financial instrument. For certain instruments, the fair value may be determined using assumptions which are not observable in the market.

| As at 31 December 2017 | Notes | Level 1 LKR 000 | Level 2 LKR 000 | Level 3 LKR 000 | Fair value LKR 000 | Carrying amount LKR 000 |
|---|---|---|---|---|---|---|
| **Assets** | | | | | | |
| Cash and cash equivalents | 25 | | 4,106,225 | | 4,106,225 | 4,106,225 |
| Balances with Central Bank of Sri Lanka | 26 | | 10,557,688 | | 10,557,688 | 10,557,688 |
| Placements with banks | 27 | | 6,691,381 | | 6,691,381 | 6,691,381 |
| Loans to and receivables from banks | 29 | | 10,984,266 | | 10,984,266 | 10,984,266 |
| Loans to and receivables from other customers | 30 | | | 208,781,978 | 208,781,978 | 213,675,866 |
| Financial investments – Held-to-maturity | 32 | 22,518,347 | 1,498,338 | | 24,016,685 | 23,507,632 |
| Due from subsidiaries | | | | 12,083 | 12,083 | 12,083 |
| Other assets | | | | 2,775,741 | 2,775,741 | 2,775,741 |
| Total | | 22,518,347 | 33,837,898 | 211,569,802 | 267,926,047 | 272,310,882 |
| **Liabilities** | | | | | | |
| Due to banks | 44 | | 9,640,735 | | 9,640,735 | 9,640,735 |
| Due to other customers | 45 | | | 193,185,964 | 193,185,964 | 193,307,534 |
| Other borrowing | 46 | | 41,319,591 | | 41,319,591 | 41,319,591 |
| Debt securities issued | 47 | | 24,435,795 | | 24,435,795 | 24,443,767 |
| Subordinated term debt | 49 | | 8,938,245 | | 8,938,245 | 9,202,870 |
| Other liabilities | 48 | | | 4,078,984 | 4,078,984 | 4,078,984 |
| Total | | – | 84,334,366 | 197,264,948 | 281,599,314 | 281,993,481 |

| *As at 31 December 2016* | Notes | Level 1 LKR 000 | Level 2 LKR 000 | Level 3 LKR 000 | Fair value LKR 000 | Carrying amount LKR 000 |
|---|---|---|---|---|---|---|
| **Assets** | | | | | | |
| Cash and cash equivalents | 25 | | 4,330,934 | | 4,330,934 | 4,330,934 |
| Balances with Central Bank of Sri Lanka | 26 | | 8,062,567 | | 8,062,567 | 8,062,567 |
| Placements with banks | 27 | | 1,351,117 | | 1,351,117 | 1,351,117 |
| Loans to and receivables from banks | 29 | | 12,300,398 | | 12,300,398 | 12,300,398 |
| Loans to and receivables from other customers | 30 | | | 183,514,729 | 183,514,729 | 185,784,979 |
| Financial investments – Held to maturity | 32 | 13,757,420 | 2,372,636 | | 16,130,056 | 23,189,085 |
| Other assets | | | | 2,562,978 | 2,562,978 | 2,562,978 |
| Total | | 13,757,420 | 28,417,652 | 186,077,707 | 228,252,779 | 237,582,058 |
| **Liabilities** | | | | | | |
| Due to banks | 44 | | 18,103,587 | | 18,103,587 | 18,103,587 |
| Due to other customers | 45 | | | 139,995,435 | 139,995,435 | 140,514,373 |
| Other borrowing | 46 | | | 40,751,346 | 40,751,346 | 40,751,346 |
| Debt securities issued | 47 | | 28,077,060 | | 28,077,060 | 29,179,185 |
| Subordinated term debt | 49 | | 8,796,976 | | 8,796,976 | 9,205,637 |
| Other liabilities | 48 | | | 3,850,826 | 3,850,826 | 3,850,826 |
| Total | | – | 54,977,623 | 184,597,607 | 239,530,230 | 241,559,554 |

## *59.6 Fair Value of Financial Instruments Carried at Amortised Cost – Group*

The following table summarises the carrying amounts and the Group's estimate of fair values of those financial assets and liabilities not presented on the Group's Statement of Financial Position at fair value. The fair values in the table below may be different from the actual amounts that will be received/paid on the settlement or maturity of the financial instrument. For certain instruments, the fair value may be determined using assumptions which are not observable in the market.

| *As at 31 December 2017* | Notes | Level 1 LKR 000 | Level 2 LKR 000 | Level 3 LKR 000 | Fair value LKR 000 | Carrying amount LKR 000 |
|---|---|---|---|---|---|---|
| **Assets** | | | | | | |
| Cash and cash equivalents | **25** | | **4,120,230** | | **4,120,230** | **4,120,230** |
| Balances with Central Bank of Sri Lanka | **26** | | **10,557,688** | | **10,557,688** | **10,557,688** |
| Placements with banks | **27** | | **6,712,131** | | **6,712,131** | **6,712,131** |
| Loans to and receivables from banks | **29** | | **10,984,266** | | **10,984,266** | **10,984,266** |
| Loans to and receivables from other customers | **30** | | | **208,781,978** | **208,781,978** | **213,675,866** |
| Financial investments – Held to maturity | **32** | **22,518,347** | **1,498,338** | | **24,016,685** | **23,507,632** |
| Other assets | | | | **2,804,798** | **2,804,798** | **2,804,798** |
| Total | | **22,518,347** | **33,872,653** | **211,586,776** | **267,977,776** | **272,362,611** |
| **Liabilities** | | | | | | |
| Due to banks | **44** | | **9,640,735** | | **9,640,735** | **9,640,735** |
| Due to other customers | **45** | | | **192,798,577** | **192,798,577** | **192,920,147** |
| Other borrowing | **46** | | | **41,290,874** | **41,290,874** | **41,290,874** |
| Debt securities issued | **47** | | **24,435,795** | | **24,435,795** | **24,443,767** |
| Subordinated term debt | **49** | | **8,938,245** | | **8,938,245** | **9,202,870** |
| Other liabilities | **48** | | | **4,195,940** | **4,195,940** | **4,195,940** |
| | | **–** | **43,014,775** | **238,285,391** | **281,300,166** | **281,694,333** |

| *As at 31 December 2016* | Notes | Level 1<br>LKR 000 | Level 2<br>LKR 000 | Level 3<br>LKR 000 | Fair value<br>LKR 000 | Carrying amount<br>LKR 000 |
|---|---|---|---|---|---|---|
| **Assets** | | | | | | |
| Cash and cash equivalents | 25 | | 4,344,260 | | 4,344,260 | 4,344,260 |
| Balances with Central Bank of Sri Lanka | 26 | | 8,062,567 | | 8,062,567 | 8,062,567 |
| Placements with banks | 27 | | 1,415,985 | | 1,415,985 | 1,415,985 |
| Loans to and receivables from banks | 29 | | 12,300,398 | | 12,300,398 | 12,300,398 |
| Loans to and receivables from other customers | 30 | | | 183,514,729 | 183,514,729 | 185,784,979 |
| Financial investments – Held to maturity | 32 | 13,757,420 | 2,372,636 | | 16,130,056 | 23,189,085 |
| Other assets | | | | 2,609,655 | 2,609,655 | 2,609,655 |
| Total | | 13,757,420 | 28,495,846 | 189,124,384 | 228,377,650 | 237,706,929 |
| **Liabilities** | | | | | | |
| Due to banks | 44 | | 18,103,587 | | 18,103,587 | 18,103,587 |
| Due to other customers | 45 | | | 139,364,164 | 139,364,164 | 140,219,872 |
| Other borrowing | 46 | | | 40,736,300 | 40,736,300 | 40,736,300 |
| Debt securities issued | 47 | | 28,077,060 | | 28,077,060 | 29,179,185 |
| Subordinated term debt | 49 | | 8,796,976 | | 8,796,976 | 9,205,637 |
| Other liabilities | 48 | | | 3,961,249 | 3,961,249 | 3,961,249 |
| | | | 54,977,623 | 184,061,717 | 239,039,341 | 241,405,830 |

Given below is the basis adopted by the Bank/Group in order to establish the fair values of the financial instruments.

## *59.7 Cash and Cash Equivalents and Placements with Banks*

Carrying amounts of cash and cash equivalents and placements with banks approximates their fair value as these balances have a remaining maturity of less than three months from the reporting date.

## *59.8 Loans to and Receivables from Banks and Other Customers*

### *59.8.1 Lease Rentals Receivable – Bank*

The estimated fair value of lease rentals receivable is the present value of future cash flows expected to be received from such finance lease facilities calculated based on current interest rates for similar type of facilities. The finance lease portfolio is at fixed interest rates and the fair value calculated on this basis as at 31 December 2017 was LKR 15,531 million as against a carrying value of LKR 16,493 million. (As at 31 December 2016 – fair value calculated on this basis was LKR 14,412 million as against a carrying value of LKR 15,909 million).

### *59.8.2 Other Loans*

Composition:

| | % |
|---|---|
| Floating rate loan portfolio | 56 |
| Fixed rate loans | |
| – With remaining maturity less than one year | 7 |
| – Others | 37 |
| Total | 100 |

Since the floating rate loans can be repriced monthly, quarterly and semi-annually in tandem with market rates fair value of these loans is approximately same as the carrying value. Carrying amount of fixed rate loans with a remaining maturity of less than one year approximates the fair value.

Based on the results of the fair value computed on the lease rentals receivable, it is estimated that the fair value of the other loans at fixed interest rates with maturity of more than one year is not materially different to its carrying value as at the reporting date.

### 59.9 Financial Investments – Held to Maturity

Fair value of the fixed rate debentures are based on prices quoted in the Colombo Stock Exchange, where there is an active market for quoted debentures.

Where there is no active market, fair value of the fixed rate debentures has been determined by discounting the future cash flows by the interest rates derived with reference to Government Treasury Bond rates with adjustments to risk premiums at the time of investment.

### 59.10 Due to Banks

Carrying value of amounts due to banks approximates their fair value as these balances have a remaining maturity of less than one year from the reporting date.

### 59.11 Due to Other Customers

The carrying value of deposits with a remaining maturity of less than one year approximates the fair value.

Fair values of deposits with a remaining maturity of more than one year is estimated using discounted cash flows applying current interest rates offered for deposits of similar remaining maturities.

The fair value of a deposit repayable on demand is assumed to be the amount payable on demand at the reporting date and the savings account balances are repriced frequently to match with the current market rates, therefore the demand and saving deposits carrying amounts are reasonable approximation to the fair values as at the reporting date.

### 59.12 Other Borrowings

This consists of borrowings sourced from multilateral and bilateral institutions. Seventy per cent of these borrowing are repriced either monthly, quarterly or semi-annually and rates are revised in line with changes in market rates. Hence the carrying value of these borrowings approximates the fair value.

The others at fixed rates which relates to borrowings on credit lines are based on interest rates which are specific to each refinancing arrangement and as such there are no comparable market rates. Hence, the fair value approximates the carrying value.

### 59.13 Debt Securities Issued

Debts issued comprise the USD notes issue and LKR debentures. Fair value of the USD notes are determined by reference to the bid and ask price quoted in the Singapore Stock Exchange. The LKR debentures are fair valued by reference to current Government Treasury Bond rates with a risk premium.

## 60 Financial Risk Management

### 60.1 Introduction and Overview

Bank has exposure to the following key risks from financial instruments:

- Credit risk
- Liquidity risk
- Operational risk
- Market risk

This note presents information about the Bank's exposure to each of the above risks, the objectives, policies and processes for measuring and managing such risks.

### Risk Management Framework

The Board of Directors has the overall responsibility for the establishment and oversight of the Bank's risk management framework. It has set up a Board Integrated Risk Management Committee (BIRMC) with three Non-Executive Directors including the Chairman, one Executive Director and Chief Risk Officer (CRO) as members. CRO represents at the BIRMC the supervision and the management of the broad risk categories including credit, liquidity market risk, and strategic risk. As per the Board approved Charter, BIRMC assists the Board to manage these risks prudently. Bank's risk management policies are established to identify and analyse the risks faced by the Bank, to set appropriate risk limits and to monitor adherence to limits. Risk management policies and systems are reviewed at least annually to reflect changes in market conditions, business strategy, products and services offered.

## 60.2 Credit Risk

### 60.2.1 Qualitative Disclosures

Credit risk is the risk of financial loss to the Bank if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from Bank's loans and advances to customers and other banks and investment in debt securities. Management of credit risk includes the following elements:

1. Formulating credit policies in consultation with business units covering collateral requirements, credit assessment, risk grading and reporting, documentary and legal procedures and compliance with regulatory and statutory requirements.
2. Establishing the authorisation structure for the approval and renewal of credit facilities.
3. Limiting concentration of exposures to counterparties and industries.
4. Developing and maintaining Bank's risk grading models in order to categorise exposures according to the degree of risk of financial loss and to focus management on the attendant risks.
5. Independent risk assessment, monitoring, recommending and reporting by the IRMD.
6. Reviewing compliance through regular audits by internal audit.

### 60.2.2 Quantitative Disclosures

| | BANK | | GROUP | |
|---|---|---|---|---|
| *As at* | **31.12.2017 LKR 000** | 31.12.2016 LKR 000 | **31.12.2017 LKR 000** | 31.12.2016 LKR 000 |
| ***60.2.2.1 Loans to and Receivables from Other Customers*** | | | | |
| **Individually Impaired** | | | | |
| Gross amount | **6,762,473** | 6,010,399 | **6,762,473** | 6,010,399 |
| Allowance for impairment | **(5,388,754)** | (4,778,752) | **(5,388,754)** | (4,778,752) |
| Carrying amount | **1,373,719** | 1,231,647 | **1,373,719** | 1,231,647 |
| **Collectively Impaired** | | | | |
| Gross amount | **3,013,772** | 2,628,487 | **3,013,772** | 2,628,487 |
| Allowance for impairment | **(2,244,951)** | (1,890,798) | **(2,244,951)** | (1,890,798) |
| Carrying amount | **768,821** | 737,689 | **768,821** | 737,689 |
| **Past Due But Not Impaired** | | | | |
| Gross amount | **77,509,049** | 60,879,323 | **77,509,049** | 60,879,323 |
| Allowance for impairment | **–** | – | **–** | – |
| Carrying amount | **77,509,049** | 60,879,323 | **77,509,049** | 60,879,323 |

| As at | BANK 31.12.2017 LKR 000 | BANK 31.12.2016 LKR 000 | GROUP 31.12.2017 LKR 000 | GROUP 31.12.2016 LKR 000 |
|---|---|---|---|---|
| **Neither Past Due Nor Impaired** | | | | |
| Gross amount | **134,024,277** | 122,936,320 | **134,024,277** | 122,936,320 |
| Allowance for impairment | **–** | – | **–** | – |
| Carrying amount* | **134,024,277** | 122,936,320 | **134,024,277** | 122,936,320 |
| Carrying amount – amortised cost | **213,675,866** | 185,784,979 | **213,675,866** | 185,784,979 |

### 60.2.2.2 Loans to and Receivables from Banks

| As at | BANK 31.12.2017 LKR 000 | BANK 31.12.2016 LKR 000 | GROUP 31.12.2017 LKR 000 | GROUP 31.12.2016 LKR 000 |
|---|---|---|---|---|
| **Neither Past Due Nor Impaired** | | | | |
| Gross amount | **10,984,266** | 12,300,398 | **10,984,266** | 12,300,398 |
| Allowance for impairment | **–** | – | **–** | – |
| Carrying amount | **10,984,266** | 12,300,398 | **10,984,266** | 12,300,398 |

### 60.2.2.3 Analysis of Security Values of Loans to and Receivables from Other Customers

| As at | BANK Gross loan balance 31.12.2017 LKR 000 | BANK Security value 31.12.2017 LKR 000 | BANK Gross loan balance 31.12.2016 LKR 000 | BANK Security value 31.12.2016 LKR 000 | GROUP Gross loan balance 31.12.2017 LKR 000 | GROUP Security value 31.12.2017 LKR 000 | GROUP Gross loan balance 31.12.2016 LKR 000 | GROUP Security value 31.12.2016 LKR 000 |
|---|---|---|---|---|---|---|---|---|
| **Against Individually Impaired** | | | | | | | | |
| Mortgages over property, plant and machinery | **1,436,747** | **1,380,943** | 1,612,896 | 1,449,450 | **1,436,747** | **1,380,943** | 1,612,896 | 1,449,450 |
| Others | **1,099,530** | **630** | 596,865 | 510,898 | **1,099,530** | **630** | 596,865 | 510,898 |
| Unsecured | **4,217,884** | **–** | 3,714,601 | – | **4,217,884** | **–** | 3,714,601 | – |
| **Against Collectively Impaired** | | | | | | | | |
| Mortgages over property, plant and machinery | **1,099,966** | **2,468,887** | 1,060,924 | 2,319,203 | **1,099,966** | **2,468,887** | 1,060,924 | 2,319,203 |
| Others | **246,882** | **32,013** | 218,186 | 14,665 | **246,882** | **32,013** | 218,186 | 14,665 |
| Unsecured | **1,550,494** | **–** | 1,239,662 | – | **1,550,494** | **–** | 1,239,662 | – |
| **Against Past Due But Not Impaired** | | | | | | | | |
| Mortgages over property, plant and machinery | **36,423,748** | **85,688,766** | 30,660,982 | 70,102,950 | **36,423,748** | **85,688,766** | 30,660,982 | 70,102,950 |
| Others | **23,163,025** | **7,414,791** | 17,520,717 | 5,618,646 | **23,163,025** | **7,414,791** | 17,520,717 | 5,618,646 |
| Unsecured | **9,919,502** | **–** | 6,965,357 | – | **9,919,502** | **–** | 6,965,357 | – |

| As at | BANK | | | | GROUP | | | |
|---|---|---|---|---|---|---|---|---|
| | **Gross loan balance 31.12.2017 LKR 000** | **Security value 31.12.2017 LKR 000** | Gross loan balance 31.12.2016 LKR 000 | Security value 31.12.2016 LKR 000 | **Gross loan balance 31.12.2017 LKR 000** | **Security value 31.12.2017 LKR 000** | Gross loan balance 31.12.2016 LKR 000 | Security value 31.12.2016 LKR 000 |
| Mortgages over property, plant and machinery | **43,732,774** | **117,966,759** | 41,775,571 | 100,725,378 | **43,732,774** | **117,966,759** | 41,775,571 | 100,725,378 |
| Treasury guarantee | **5,594,370** | **6,166,733** | 5,874,580 | 7,180,759 | **5,594,370** | **6,166,733** | 5,874,580 | 7,180,759 |
| Debt securities | **187,500** | **187,500** | 517,500 | 517,500 | **187,500** | **187,500** | 517,500 | 517,500 |
| Equity | **1,616,546** | **1,748,988** | 1,767,950 | 1,937,591 | **1,616,546** | **1,748,988** | 1,767,950 | 1,937,591 |
| Others | **42,412,026** | **11,484,079** | 37,513,754 | 9,480,430 | **42,412,026** | **11,484,079** | 37,513,754 | 9,480,430 |
| Unsecured | **32,115,203** | – | 25,505,832 | – | **32,115,203** | – | 25,505,832 | – |
| Total | **204,816,197** | **234,540,089** | 176,545,377 | 199,857,470 | **204,816,197** | **234,540,089** | 176,545,377 | 199,857,470 |

The above analysis does not include balances relating to lease rentals receivable.

## *60.3 Liquidity Risk*

### *60.3.1 Qualitative Disclosures*

Liquidity risk is the risk that the Bank will not have sufficient financial resources to meet Bank's obligations as they fall due. This risk arises from mismatches in the timing of cash flows.

Management of liquidity risk includes the following elements:

a. Taking steps to ensure, as far as possible, that the Bank will always have sufficient financial resources to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Bank's reputation.

b. The Asset and Liability Committee (ALCO) is mandated to execute liquidity management policies, procedures and practices approved by the Board of Directors, effectively.

c. Monitoring of potential liquidity requirements and availability using the maturity analysis and cash flow forecast under normal and stressed conditions using a flow approach.

d. Monitoring the Group's liquidity through the Liquid Assets Ratio (statutory minimum is currently 20%) and Liquidity Coverage Ratios using a stock approach.

e. Effecting threshold limits relevant for liquidity management as part of the overall risk limits system of the Bank.

### *60.3.2 Quantitative Disclosures*

| Regulatory Liquidity (Bank) | 31.12.2017 | 31.12.2016 |
|---|---|---|
| Statutory liquid assets (LKR'000) | 71,672,283 | 59,259,909 |
| Statutory liquid assets ratio (mininum requirement 20%) | | |
| Domestic banking unit (%) | 24.34 | 24.56 |
| Off-shore banking unit (%) | 67.7 | 73.2 |
| Liquidity Coverage Ratio (minimum requirement 80% in 2017 and 70% in 2016) | | |
| All currencies (%) | 108.5 | 168.8 |
| Rupee only (%) | 127.8 | 197.3 |

### 63.3.2.1 Maturity Profile of Financial Liabilities of the Bank

| As at 31 December 2017 | Carrying Amount | Total | Up to 3 months | | 3 to 12 months | | 1 to 3 years | | 3 to 5 years | | >5 years | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | LKR 000 | LKR 000 | LKR 000 | % | LKR 000 | % | LKR 000 | % | LKR 000 | % | LKR 000 | % |
| Liabilities with contractual maturity (Interest bearing liabilities) | | | | | | | | | | | | |
| Due to banks | 9,636,351 | 9,642,565 | 110,083 | 1 | 7,530,736 | 78 | 2,001,746 | 21 | – | – | – | – |
| Due to other customers | 188,838,665 | 189,024,016 | 78,004,690 | 41 | 59,135,540 | 31 | 10,401,732 | 6 | 9,459,778 | 5 | 32,022,276 | 17 |
| Other Borrowings | 41,319,591 | 41,322,672 | 1,591,024 | 4 | 3,402,175 | 8 | 11,548,027 | 28 | 11,678,491 | 28 | 13,102,955 | 32 |
| Subordinated term debts | 9,202,870 | 9,211,816 | – | – | – | – | 2,103,367 | 23 | 7,108,449 | 77 | – | – |
| Debt securities issued | 24,443,767 | 24,467,481 | – | – | 15,559,280 | 64 | 8,908,201 | 36 | – | – | – | – |
| | 273,441,244 | 273,668,550 | 79,705,797 | | 85,627,731 | | 34,963,073 | | 28,246,718 | | 45,125,231 | |
| Other liabilities (Non-interest bearing liabilities) | | | | | | | | | | | | |
| Due to banks | 4,384 | 4,384 | 4,384 | 100 | – | – | – | – | – | – | – | – |
| Derivative financial instruments | 367,435 | 367,435 | 367,435 | 100 | – | – | – | – | – | – | – | – |
| Due to other customers | 4,468,869 | 4,468,869 | 1,874,658 | 42 | 1,539,215 | 34 | – | – | – | – | 1,054,996 | 24 |
| Current tax payable | 633,636 | 485,418 | 485,418 | 100 | – | – | – | – | – | – | – | – |
| Deferred tax liability | 1,194,027 | 1,003,444 | 1,003,444 | 100 | – | – | – | – | – | – | – | – |
| Government Grant -deferred Income | 654,583 | 654,583 | – | – | 654,583 | 100 | – | – | – | – | – | – |
| Other liabilities | 4,466,398 | 3,933,488 | 2,087,933 | 53 | 1,459,171 | 37 | 38,984 | 1 | 38,984 | 1 | 308,416 | 8 |
| Total equity | 47,876,766 | 34,526,467 | – | – | – | – | – | – | – | – | 34,526,467 | |
| | 59,666,098 | 45,444,088 | 5,823,272 | | 3,652,969 | | 38,984 | | 38,984 | | 35,889,879 | |
| Total Equity and Liabilities | 333,107,342 | 319,112,638 | 85,529,069 | | 89,280,700 | | 35,002,057 | | 28,285,702 | | 81,015,110 | |

### 63.3.2.2 Maturity Profile of Financial Liabilities of the Group

| As at 31 December 2017 | Carrying Amount | Total | Up to 3 months | | 3 to 12 months | | 1 to 3 years | | 3 to 5 years | | >5 years | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | LKR 000 | LKR 000 | LKR 000 | % | LKR 000 | % | LKR 000 | % | LKR 000 | % | LKR 000 | % |
| Liabilities with contractual maturity (Interest bearing liabilities) | | | | | | | | | | | | |
| Due to banks | 9,636,351 | 9,642,565 | 110,083 | 1 | 7,530,736 | 78 | 2,001,746 | 21 | – | – | – | – |
| Due to other customers | 188,451,278 | 188,636,629 | 77,617,303 | 41 | 59,135,540 | 31 | 10,401,732 | 6 | 9,459,778 | 5 | 32,022,276 | 17 |
| Other Borrowings | 41,290,874 | 41,293,955 | 1,562,307 | 4 | 3,402,175 | 8 | 11,548,027 | 28 | 11,678,491 | 28 | 13,102,955 | 32 |
| Subordinated term debts | 9,202,870 | 9,211,816 | – | – | – | – | 2,103,367 | 23 | 7,108,449 | 77 | – | – |
| Debt securities issued | 24,443,767 | 24,467,481 | – | – | 15,559,280 | 64 | 8,908,201 | 36 | – | – | – | – |
| | 273,025,140 | 273,252,446 | 79,289,693 | | 85,627,731 | | 34,963,073 | | 28,246,718 | | 45,125,231 | |
| Other liabilities (Non-interest bearing liabilities) | | | | | | | | | | | | |
| Due to banks | 4,384 | 4,384 | 4,384 | 100 | – | – | – | – | – | – | – | – |
| Derivative financial instruments | 367,435 | 367,435 | 367,435 | 100 | – | – | – | – | – | – | – | – |
| Due to other customers | 4,468,869 | 4,468,869 | 1,874,658 | 42 | 1,539,215 | 34 | – | – | – | – | 1,054,996 | 24 |
| Current tax payable | 655,488 | 507,270 | 507,270 | 100 | – | – | – | – | – | – | – | – |
| Deferred tax liability | 1,232,478 | 1,041,895 | 1,041,895 | 100 | – | – | – | – | – | – | – | – |
| Government Grant -deferred Income | 654,583 | 654,583 | – | – | 654,583 | 100 | – | – | – | – | – | – |
| Other liabilities | 4,657,628 | 4,124,718 | 2,126,179 | 52 | 1,497,417 | 36 | 77,230 | 2 | 77,230 | 2 | 346,662 | 8 |
| Total equity | 49,401,857 | 36,051,558 | – | – | – | – | – | – | – | – | 36,051,558 | |
| | 61,442,722 | 47,220,712 | 5,921,821 | | 3,691,215 | | 77,230 | | 77,230 | | 37,453,216 | |
| Total Equity and Liabilities | 334,467,862 | 320,473,158 | 85,211,514 | | 89,318,946 | | 35,040,303 | | 28,323,948 | | 82,578,447 | |

## 60.4 Market Risk

### 60.4.1 Qualitative Disclosures

Market risk is the possibility of losses arising from changes in the value of a financial instrument as a result of changes in market variables, such as interest rates, equity prices, foreign exchange rates and commodity prices which will affect the Bank's income or the value of its holdings of financial instruments. The objective of the Bank' s market risk management is to manage and control market risk exposures within acceptable parameters, in order to ensure the Bank' s solvency and the income growth, while optimising the return on risk.

#### 60.4.1.1 Management of Market Risks

The following policy frameworks stipulate the policies and practices for management, monitoring and reporting of market risk:

a. Market risk management framework

b. ALCO charter

c. Treasury trading guidelines and limits system

d. Treasury manual

e. Overall risk limits for market risk management

f. New product development policy

Overall authority for managing market risk is vested with the Board of Directors through the Board Integrated Risk Management Committee (BIRMC). The operational authority for managing market risk is vested with ALCO. Foreign exchange risk is managed within approved limits and segregation of reporting responsibilities of Treasury Front Office, Middle Office and Back Office.

Exposure to market risk arises from two sources viz trading portfolios from positions arising from market-making activities, and non-trading portfolios from positions arising from financial investments designated as available for sale (AFS) and held to maturity and from derivatives held-for-risk management purposes.

### *60.4.2 Quantitative Disclosures*

In the case of interest rate and foreign exchange risk the following analysis is in respect of DFCC Bank PLC.

#### *60.4.2.1 Interest Rate Risk – DFCC*

#### *60.4.2.1.1 Duration Analysis as at 31 December 2017*

| Portfolio | Face value LKR 000 | Mark-to-market value LKR 000 | Duration | Interpretation of duration |
|---|---|---|---|---|
| Government securities trading portfolio | 250,000.00 | 271,381.20 | 5.49% | Portfolio value will decline approximately by 5.49% as a result of 1% increase in the interest rates. |
| Treasury Securities AFS portfolio | 37,564,690 | 37,222,299 | 1.60% | Portfolio value will decline approximately by 1.60% as a result of 1% increase in the interest rates. |

Market risk exposure for interest rate risk in the Trading portfolio as at 31 December 2017 is depicted by duration of 5.49%.

This level of interest rate risk exposure can be interpreted as a possible potential loss in the marked-to-market value amounting to LKR 14.9 million. in case, the market interest rates mark a parallel upward shift of 1%.

Therefore maximum holding period is restricted to 91 days for the Trading Portfolio.

Market risk exposure for interest rate risk in the AFS portfolio as at 31 December 2017 is depicted by duration of 1.60%. This level of interest rate risk exposure in the AFS portfolio can be interpreted as a possible potential loss in the marked-to-market value amounting to LKR 596.3 million, as at 31 December 2017

#### *60.4.2.1.2 Potential Impact to NII Due to Change in Market Interest Rates*

Overall up to the 12-month time bucket, DFCC carried a net liability sensitive position. This liability sensitivity will vary for each time bucket up to the 12-month period. The interest rate risk exposure as at 31 December 2017 is quantified based on the assumed change in the interest rates for each time period and is given in table below:

| | 0 to 1 month LKR 000 | Over 1 – up to 3 months LKR 000 | Over 3 – up to 6 months LKR 000 | Over 6 – up to 12 months LKR 000 |
|---|---|---|---|---|
| Total interest-bearing assets | 128,103,811 | 9,954,432 | 19,845,446 | 30,972,667 |
| Total interest-bearing liabilities | 73,289,039 | 53,465,749 | 53,659,162 | 30,460,078 |
| Net rate sensitive assets (liabilities) | 54,814,772 | (43,511,317) | (33,813,716) | 512,589 |
| Assumed change in interest rates (%) | 0.50% | 1.00% | 1.50% | 2.00% |
| Impact | 274,074 | (398,854) | (380,404) | 5,126 |
| Total net impact if interest rates increase | – | – | – | (500,058) |
| Total net impact if interest rates decline | – | – | – | 500,058 |

We have assumed that the assets and liabilities are re-priced at the beginning of each time bucket and have also taken into account the remaining time from the repricing date up to one year.

### *60.4.2.2 Forex Risk in Net Open Position (NOP)/Unhedged Position of DFCC*

The following table indicates the DFCC's exchange rate risk exposure based on its size of the NOP/unhedged positions in the foreign currency assets/liabilities. By 31 December 2017, DFCC carried a USD equivalent net open/unhedged "Oversold" position of LKR 65.6 million. The impact of exchange rate risk is given below:

| | Amount |
|---|---|
| Net exposure – USD equivalent | (427,000) |
| Value of position in LKR 000 | (65,587) |
| Exchange rate (USD/LKR) as at 31 December 2017 | 153.60 |
| Possible potential loss to DFCC – LKR 000 | |
| If Exchange rate (USD/LKR) depreciates by 1% | (656) |
| If exchange rate depreciates by 10% | (6,559) |
| If exchange rate depreciates by 15% | (9,838) |

The estimated potential exchange loss is off set by the interest gain due to interest differential between LKR and the respective foreign currencies.

### *60.4.2.3 Equity Price Risk*

Equity prices risk is part of market risk which is defined as the risk of possible losses arising from the equity market investments due to changes in the market prices of the invested shares. The Bank is exposed to equity prices risk through its investments in the equity market which has been shown in the trading and AFS portfolio.

| Parameter | **Position as at 31 December 2017 LKR 000** | Position as at 31 December 2016 LKR 000 |
|---|---|---|
| Marked-to-market value of the total quoted equity portfolio | **18,226,836** | 18,797,640 |
| Value-at-risk (under 99% probability for a quarterly time horizon) | **7.68%** | 10.03% |
| Maximum possible loss of value in the marked-to-market value of the portfolio as indicated by the VAR over a quarterly period | **1,399,821** | 1,885,403 |
| Unrealised gains in the AFS equity portfolio reported in the fair value reserve | **12,668,565** | 14,580,102 |

Equity price risk is quantified using the Value at Risk (VAR) approach based on the Historical Loss Method. Historical two-year portfolio returns is adopted to compute VAR as a measure of the equity prices risk exposure by DFCC Bank. This VAR computation for the equity AFS portfolio considers a quarterly time horizon.

### *60.4.2.4 Market Risk Exposures of DFCC Group for Regulatory Capital Assessment as at 31 December 2017*

Under the Standardised Approach of Basel III with effect from July 2017, market risk exposures are quantified for regulatory capital purposes. The computation results as at 31 December 2017 are as follows:

| | Risk-weighted assets LKR 000 | Quantified possible exposure LKR 000 |
|---|---|---|
| Interest rate risk | 7,872,233 | 885,626 |
| Equity prices risk | 111,709 | 12,567 |
| Foreign exchange and gold risk | 125,971 | 14,172 |
| **Total** | **8,109,913** | **912,365** |

## *60.5 Operational Risk*

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the Bank relating to processes, personnel, technology and infrastructure and from external factors.

DFCC Bank's objective is to manage operational risk so as to balance the avoidance of financial losses and damage to the Bank's reputation with overall cost effectiveness whilst avoiding control procedures that restrict initiative and creativity.

### *60.5.1 Qualitative Disclosures*

The following are included in the process of the operational risk management in DFCC Bank.

a. Monitoring of the Key Risk Indicators (KRIs) for the departments/functions under the defined threshold limits using a traffic light system. Develop Risk and Control Self-Assessments to identify the risk exposure of all processes.

b. Operational risk incident reporting system and the independent analysis of the incidents by the IRMD, and recognise necessary improvements in the systems, processes and procedures.

c. Analyse downtime of the critical systems, attrition information, exit interview comments and complaints to identify operational risks and recommend mitigating controls. The key findings of the analysis are evaluated at the ORMC and the BIRMC meetings in an operational risk perspective.

The primary responsibility for the development and implementation of controls to address operational risk lies with IRMD whilst implementation is assigned to Senior Management within each business unit. This responsibility is supported by the development of overall standards for management of operational risk in the following areas:

a. Requirements for appropriate segregation of duties, including independent authorisation of transactions

b. Requirements for reconciliation and monitoring of transactions

c. Compliance with regulatory and other legal requirements

d. Documentation of controls and procedures

e. Requirements for periodic assessment of operational risks faced and the adequacy of controls and procedures to address the identified risks

f. Requirements for reporting of operational losses and propose remedial action

g. Development of contingency plans

h. Training and professional development to establish ethics and business standards

j. Insurance covering risk due to threats arising from external and other events.

Compliance with the Bank's standards is supported by a programme of periodic reviews undertaken by internal audit. The results of internal audit reviews are discussed with the business unit to which they relate, with summaries submitted to the Audit Committee and Senior Management.

## 60.6 Capital Management

### 60.6.1 Qualitative Disclosures

DFCC Bank PLC manages its capital at Bank and Group level considering both regulatory requirement and risk exposures. Its regulatory capital position is analysed by the BIRMC on a quarterly basis and recommendations and decisions are made accordingly. The Group capital management goals are as follows:

a. Ensure regulatory minimum capital adequacy requirements are not compromised.

b. Bank to maintain its international and local credit rating and to ensure that no downgrading occurs as a result of deterioration of risk capital of the Bank.

c. Ensure above industry average Capital Adequacy Ratio is maintained.

d. Ensure maintaining of quality capital.

e. Ensure capital impact of business decisions are properly assessed and taken into consideration during product planning and approval process.

f. Ensure capital consumption by business actions are adequately priced.

Central Bank of Sri Lanka sets and monitors regulatory capital requirement on both consolidated and solo basis. The Bank is required to comply with the provisions of the Basel II and commencing from July 2017 the Basel III requirements in respect of regulatory capital. The Bank currently uses the standardised approach for credit risk and market risk and basic indicator approach for operational risk.

The Basel III capital regulations, which are planned to be implemented on a phased in basis by 2019 starting from mid 2017, will continue to be based on the three-mutually reinforcing Pillars introduced under Basel II, i.e., minimum capital requirement, supervisory review process and market discipline. Basel III focuses on increasing the quality and quantity of capital especially the Core Capital, through redefining the common equity capital and introducing new capital buffers such as the Capital Conservation Buffer and a Capital Surcharge on Domestic Systematically Important Banks. DFCC Bank started reporting capital computations under the Basel III requirements from mid 2017 as per the regulatory requirements.

Regulatory capital comprises Tier I capital and Tier II capital. The Bank's policy is to maintain a strong capital base so as to ensure investor, creditor and market confidence to sustain future development of the business.

DFCC Bank and its Group have complied with the minimum capital requirements imposed by the Central Bank of Sri Lanka throughout the year.

### 60.6.2 Key Regulatory Ratios – Capital

| *As at* | 31.12.2017 | | 31.12.2016 | |
|---|---|---|---|---|
| | **Bank** | **Group** | **Bank** | Group |
| Regulatory capital (LKR 000) | | | | |
| Common equity Tier 1 | **33,017,170** | **34,211,431** | **N/A** | N/A |
| Tier 1 capital | **33,017,170** | **34,211,431** | **N/A** | N/A |
| Total capital | **41,993,352** | **43,187,613** | **N/A** | N/A |
| Regulatory capital ratios (%) | | | | |
| Common equity Tier 1 capital ratio (minimum requirement – 5.75%) | **12.68%** | **13.09%** | **N/A** | N/A |
| Tier 1 capital ratio (minimum requirement – 7.25%) | **12.68%** | **13.09%** | **N/A** | N/A |
| Total capital ratio (minimum requirement – 11.25%) | **16.13%** | **16.53%** | **N/A** | N/A |

## Basel III Computation of Capital Ratios

| As at | 31.12.2017 | |
|---|---|---|
| | Bank LKR 000 | Group LKR 000 |
| Common equity Tier 1 (CET 1) capital after adjustments | **33,017,170** | **34,211,431** |
| Common equity Tier 1 (CET 1) capital | **38,035,888** | **41,884,674** |
| Equity capital (stated capital)/assigned capital | **4,715,814** | **4,715,814** |
| Reserve fund | **2,224,275** | **2,224,275** |
| Published retained earnings/ (accumulated retained losses) | **9,607,311** | **17,357,048** |
| Published accumulated Other Comprehensive Income (OCI) | **3,457,808** | **3,807,698** |
| General and other disclosed reserves | **13,779,839** | **13,779,839** |
| Unpublished current year's profit/loss and gains reflected in OCI | – | – |
| Ordinary shares issued by consolidated banking and financial subsidiaries of the Bank and held by third parties | – | – |
| Total adjustments to CET 1 capital | **5,018,718** | **7,673,243** |
| Goodwill (net) | – | **156,226** |
| Intangible assets (net) | **498,084** | **502,411** |
| Others (investment in capital of banks and financial institutions) | **4,520,634** | **7,014,606** |
| Additional Tier 1 (AT1) capital after adjustments | – | – |
| Additional Tier 1 (AT1) capital | – | – |
| Qualifying Additional Tier 1 capital instruments | – | – |
| Instruments issued by consolidated banking and financial subsidiaries of the Bank and held by third parties | – | – |
| Total Adjustments to AT1 capital | – | – |
| Investment in own shares | – | – |
| Others (specify) | – | – |
| Tier 2 capital after adjustments | **8,976,182** | **8,976,182** |
| Tier 2 capital | **8,976,182** | **8,976,182** |
| Qualifying Tier 2 capital instruments | **8,008,628** | **8,008,628** |
| Revaluation gains | – | |
| Loan Loss Provisions | **967,554** | **967,554** |
| Instruments issued by consolidated banking and financial subsidiaries of the Bank and held by third parties | – | – |
| Total Adjustments to Tier 2 | – | – |
| Investment in own shares | – | – |
| Others (specify) | – | – |
| CET1 capital | **33,017,170** | **34,211,431** |
| Total Tier 1 capital | **33,017,170** | **34,211,431** |
| Total capital | **41,993,352** | **43,187,613** |