

BOARD SUBCOMMITTEE REPORTS

Board Audit Committee Report



This year we have introduced a mechanism to evaluate the effectiveness of external auditors strengthening our assurance pillar'



Charter of the Committee

The Charter of the BAC approved by the Board, clearly defines the Terms of Reference of the Committee and is annually reviewed to ensure that new developments relating to the Committee's functions are addressed. The Charter of the Committee was last reviewed and approved by the Board in September, 2016.

The Committee assists the Board in discharging its responsibilities and exercises oversight over financial reporting, internal audit, internal controls and external audit.

The Banking Act Direction No. 11 of 2007 on 'Corporate Governance for Licensed Commercial Banks in Sri Lanka' and its subsequent amendments (hereinafter referred to as the Direction), 'Rules on Corporate Governance under Listing Rules of the Colombo Stock Exchange' and 'Code of Best Practice on Corporate Governance', issued jointly by The Institute of Chartered Accountants of Sri Lanka and the Securities and Exchange Commission of Sri Lanka, further regulate the composition, roles and functions of the BAC.

The Committee is empowered by the Board to:

- Ensure that financial reporting systems in place are effective and well managed in order to provide accurate, appropriate and timely information to the Board, Regulatory Authorities, the Management and other stakeholders.
- Review the appropriateness of accounting policies and ensure adherence to statutory and regulatory compliance requirements and applicable Accounting Standards.
- Ensure that the Bank adopts and adheres to high standards of Corporate Governance practices, conforming to the highest ethical standards and good industry practices in the best interests of all stakeholders.

Evaluate the adequacy, efficiency and effectiveness of Risk Management measures, Internal Controls and Governance Processes in place to avoid, mitigate or transfer current and evolving risks.

- Monitor all aspects of Internal and External Audit and Inspection programmes of the Bank and review Internal and External Audit Reports for follow up with the Management on their findings and recommendations.
- Review the Interim Financial Statements and Annual Financial Statements of the Bank in order to monitor the integrity of such statements prepared for disclosure, prior to submission to the Board.

Activities in 2016

Reporting of Financial Position and Performance:

The Committee assisted the Board in its oversight on the preparation of Financial Statements to evidence a true and fair view on financial position and performance. This process is based on the Bank's accounting records and in accordance with the stipulated requirements of the Sri Lanka Accounting Standards.

The prevailing Internal Controls, systems and procedures were assessed by the Committee and it expressed the view that adequate controls and procedures were in place to provide reasonable assurance to the effect that the Bank's assets are safeguarded and the financial position of the Bank is well monitored and accurately reported.



Composition of the Committee

Board Audit Committee (the BAC) consist of following members whose profiles are given on pages 11 to 13.

Mr. S. Swarnajothi* (*Chairman*)
 Prof. A.K.W. Jayawardane* (*Director*)
 Mr. K. Dharmasiri* (*Director*)
 Ms. N.T.M.S. Cooray* (*Director*)
Appointed w.e.f. September 30, 2016
 *Independent Non-Executive Director

Regular Attendees by Invitation:

J. Durairatnam (*Managing Director/CEO*)
 S. Renganathan (*Director/Chief Operating Officer*)
 K.D.N. Buddhipala (*Chief Financial Officer*)
 S.K.K. Hettihamu (*Chief Risk Officer*)
 C. Wijetillake (*Assistant General Manager – Compliance*)
 J. Premanath (*Assistant General Manager – Management Audit*)

Secretary to the Committee:

Mr J Premanath – *Assistant General Manager – Management Audit*

Mr. Manil Jayasinghe, a senior practicing Chartered Accountant, serves the BAC in the capacity of a Consultant and is invited to attend its meetings.

Meetings

Name	Eligible to attend	Attended
Mr. S. Swarnajothi	11	11
Prof. A.K.W. Jayawardane	11	9
Mr. K. Dharmasiri	11	11
Mrs. N.T.M.S.Cooray	3	1

The committee held eleven (11) meetings during the financial year ended December 31, 2016. Proceedings of these meetings with adequate details of matters discussed are regularly reported to the Board.

Representatives of the Bank's External Auditors Messrs KPMG also participated in five (5) meetings during the year by invitation. The Committee also invited members of the Senior Management of the Bank to participate in the meetings from time to time on a needs basis.

Oversight on Regulatory Compliance:

The Committee closely scrutinised compliance with mandatory banking and other statutory requirements and the systems and procedures that are in place to ensure compliance with such requirements. The quarterly reports submitted by the Compliance Officer were used by the Committee to monitor compliance with all such legal and statutory requirements. The Bank's Inspection Department has been mandated to conduct independent test checks covering all regulatory compliance requirements, as a further monitoring measure.

Identification of Risks and Control Measures:

The Bank has adopted a risk-based audit approach and the effectiveness of the internal control procedures in place to identify and manage all significant risks are being reviewed by the Committee. A Risk Grading Matrix has been adopted for assessing and measuring the risks identified during audit assignments carried out by the Inspection Function. The Committee seeks and obtains the required assurances from Business Units on the remedial action in respect of the identified risks to maintain the effectiveness of internal control procedures.

Internal Audit and Inspection: The Committee ensures that the Internal Audit Function is independent of the activities it audited and that it was performed with impartiality, proficiency and due professional care.

The Bank's Inspection Department carries out, online and onsite inspections of local business units including Subsidiaries and overseas operations namely Bangladesh and Maldives. With the concurrence of the Board, the Bank continues to engage the services of five (5) firms of Chartered Accountants approved by the Central Bank of Sri Lanka (CBSL) in order to supplement Bank's Inspection Department in carrying out inspection assignments.

The Committee approved the Programme of Inspection formulated by Inspection Department and reviewed its implementation regularly. Five hundred and twenty (520) inspection reports on Business Units and Departments received the attention of the Committee and the operational deficiencies, risks highlighted and the recommendations were given due attention.

Major findings of internal investigations with recommendations of the management were considered and appropriate instructions issued. The Committee also invited representatives from the audit firms assisting in inspections to make presentations on their observations and findings.

Members of the Committee visited some of the branches to get a better understanding of branch operations.

External Audit: In regard to the External Audit function of the Bank, the role played by the Committee is as follows:

- Assisting the Board in engaging External Auditors for audit services, in compliance with the provisions of the Direction and agree on their remuneration with the approval of the shareholders.
- Monitoring and evaluating the independence, objectivity and effectiveness of External Auditor.
- Reviewing non-audit services provided by the Auditors, with a view to ensuring that such functions do not fall within the restricted services and provision of such services will not impair the External Auditors' independence and objectivity.
- Discussing the audit plan, scope and the methodology proposed to be adopted in conducting the audit with the Auditors prior to commencement of the annual audit.
- Discussing all relevant matters arising from the interim and final audits, and any matters the Auditor may wish to discuss, including matters that may need to be discussed in the absence of Key Management Personnel.

- Reviewing the External Auditors' Management Letter and the management's responses thereto.

The Auditors were provided with the opportunity of meeting Non-Executive Directors separately, without any Executive being present, to ensure that the Auditors had the independence to discuss and express their opinions on any matter. It provided the assurance to the Committee that the Management has fully provided all information and explanations requested by the Auditors.

At the conclusion of the audit, the Committee also met the Auditors to review the Auditors' Management Letter before it was submitted to the Board and CBSL.

Mechanism of Internal Controls: Sections 3(8)(ii) (b) and (c) of the Banking Act Direction No. 11 of 2007, stipulates the requirements to be complied with by the Bank to ensure reliability of the financial reporting system in place at the Bank. The Committee is assisted by the External Auditor and Inspection Department to closely monitor the procedures designed to maintain an effective internal control mechanism to provide reasonable assurance that this requirement is being complied with.

In addition, the Committee regularly monitored all exceptional items charged to the Income Statement, long outstanding items in the Bank's Chart of Accounts, Credit Quality, Risk Management procedures and adherence to classification of non-performing loans and provisioning requirements specified by the CBSL. The Committee also reviewed the credit monitoring and follow up procedures and the Internal Control Procedures in place to ensure that necessary control and mitigating measures are available in respect of newly identified risks.

Ethics and Good Governance : The Committee continuously emphasised on upholding ethical values of the staff members. In this regard, a Code of Ethics and Whistle-Blowers Charter was put in place and followed for educating and encouraging all members of staff to resort to whistle-blowing if they suspect wrong doings or other improprieties. Highest standards of Corporate Governance and adherence to the Bank's Code of Ethics were ensured. All appropriate procedures were in place to conduct independent investigations into incidents reported through whistle-blowing or identified through other means. The Whistle-Blowers Charter guarantees the maintenance of strict confidentiality of the identity of the whistle-blowers.

Sri Lanka Accounting Standards:

Committee reviewed the revised policy decisions relating to adoption of new and revised Sri Lanka Accounting Standards (SLFRS/LKAS) applicable to the Bank and made recommendation to the Board. The Committee would continue to monitor the compliance with relevant Accounting Standards and keep the Board informed at regular intervals.

Evaluation of the Committee:

An independent evaluation of the effectiveness of the Committee was carried out by the other Members of the Board during the year. Considering the overall conduct of the Committee and its contribution on the overall performance of the Bank, the Committee has been rated as highly effective.



S. Swarnajothi

Chairman – Board Audit Committee

Colombo
February 22, 2017