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The Board of Directors,
DFCC Bank PLC,
No. 73/5, Galle Road,
Colombo 03.

8th November 2023

Dear Sirs and Mesdames,

ACCOUNTANTS' REPORT FOR INCLUSION IN THE PROSPECTUS OF DFCC BANK PLC

This report has been prepared for the inclusion in the Prospectus issued in connection with the public offer of BASEL III compliant, subordinated, listed rated, unsecured, redeemable in 5 and 7 years debentures with a feature for Non-viability Conversion option which said debenture issue comprises an issue of 50 million of such debentures of Rs. 100/= each amounting to Rs. 5 billion; with the option to issue further 30 million debentures of Rs. 100/= each amounting to Rs. 3 billion in the event of an oversubscription of such initial issue by DFCC Bank PLC ("the Bank").

We have examined the financial statements of the Bank and the consolidated financial statements of the Bank and its subsidiaries ("the Group"), for the financial years ended 31st December 2018 to 2022 extracted from the annual reports of the respective years, included in the prospectus and report as follows.

1. INCORPORATION

DFCC Bank PLC ("the Bank") is a limited liability company incorporated and domiciled in Sri Lanka. It was incorporated in 1955 under DFCC Bank Act No. 35 of 1955. 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of the DFCC Bank (Repeal and Consequential Provisions) Act No. 39 of 2014, the DFCC Bank Act No. 35 of 1955 was repealed and the Bank was incorporated under the Companies Act No. 07 of 2007 as a public limited company listed in the Colombo Stock Exchange with the name 'DFCC Bank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 6th January 2015.

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 is engaged in provisioning 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.

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2. FINANCIAL STATEMENTS

2.1. Five Years Summary of Financial Statements

A summary of Statement of Profit or Loss and Other Comprehensive Income, Statement of Financial Position, Statement of Cash Flow and Statement of Changes in Equity of the bank for the financial years ended 31st December 2018 to 2022 based on the audited financial statements of the Bank are set out in Annexure 1.

Summaries presented for operating results, assets, liabilities and shareholders' funds for financial years ended 31st December 2018 to 2022 are based on the financial statements prepared in accordance with Sri Lanka Accounting Standards (SLFRSs and LKASs), effective from 1st January 2012 in the annual reports of the respective years.

2.2. Audit Report

We have audited the financial statements of the Bank for the years ended 31st December 2018 to 2022. Unqualified audit opinions have been issued for the said financial reporting years.

2.3. Application of Accounting Standards and Accounting Policies

The financial statements of the Bank for the financial years ended 31st December 2018 to 2022 complied with the applicable LKASs and SLFRSs.

The accounting policies of the Bank are stated in detail in the audited financial statements of DFCC Bank PLC for the year ended 31st December 2022. The adoption of revised / new accounting standards and a summary of related amendments to the accounting policies of the Bank for the financial years ended 31st December 2018 to 2022 are set out in Annexure 2.

2.4. Dividends

The Bank has paid the following dividends in respect of Ordinary Shares during the financial years ended 31st December 2018 to 2022.

Year/ Period ended;	Dividend Paid (Rs. Mn)	Dividend declared Per Share
31st December 2018	1,325	3.50*
31st December 2019	928	3.00*
31st December 2020	913	3.00**
31st December 2021	918	3.00***
31st December 2022	962	2.00***

*Cash dividends.
** Rs. 2.50 per share cash dividend and Rs. 0.50 per share scrip dividend.
***Scrip dividends.

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2.5. Events after the Reporting Date (as at 31st December 2022)

- **First and Final Dividend**

The Directors have approved the payment of a first and final dividend of Rs 2.00 per share in the form of a scrip dividend, for the financial year ended 31 December 2022. 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 Auditor.

- **Proposed Debenture Issue**

The Board of Directors decided to issue up to eighty million rupees (Rs. 80,000,000) Basel III compliant, subordinated, listed, rated, unsecured, redeemable debentures with a non-viability conversion option, each at an issue price (par value) of Rs. 100 with a term up to seven years subject to obtaining all necessary regulatory and other approvals.

Yours faithfully,

CHARTERED ACCOUNTANTS
Colombo

Annexue 1-Five year summary of Financial Statements (Bank)

Description	Years ended 31st December				
	2022 (Rs. Mn)	2021 (Rs. Mn)	2020 (Rs. Mn)	2019 (Rs. Mn)	2018 (Rs. Mn)
Operating results					
Gross income	73,008	42,649	43,300	43,297	39,154
Interest income	67,460	36,599	39,090	42,060	38,148
Interest expenses	41,391	23,946	28,083	29,398	25,733
Net interest income	26,069	12,653	11,007	12,662	12,415
Non-Interest Income	4,782	5,757	4,078	1,117	937
Operating profit before taxes on financial services	3,693	5,544	4,400	4,538	5,692
Operating profit after taxes on financial services	2,439	4,326	3,398	2,989	4,233
Profit for the year	2,513	3,222	2,388	2,074	2,768
Financial Position					
Assets					
Cash and cash equivalents	16,123	10,688	7,724	5,450	5,040
Balances with Central Bank of Sri Lanka	9,031	9,359	4,902	8,667	11,842
Placements with banks	15,225	6,288	15,414	165	425
Derivative financial assets	20,474	280	835	631	3,415
Financial assets measured at fair value through profit or loss	1,429	219	610	5,307	6,079
Financial assets at amortised cost – Loans to and receivables from banks	-	-	4,153	8,403	12,855
Financial assets at amortised cost – Loans to and receivables from other customers	369,072	365,901	301,909	272,818	249,734
Financial assets at amortised cost – Debt and other instruments	50,948	26,675	31,604	21,744	22,874
Financial assets measured at fair value through other comprehensive income	63,319	54,329	88,718	72,716	55,314
Investments in subsidiaries	237	217	217	187	167
Investments in associate	33	35	35	35	35
Investments in joint venture	755	755	755	755	755
Investment property	10	10	10	10	10
Property, plant and equipment	3,199	3,237	3,407	3,231	1,620
Intangible assets and goodwill	2,198	2,228	1,713	1,185	669
Deferred tax asset	4,138	1,359		309	492
Other assets	9,737	3,925	3,070	3,283	3,574
Total assets	**565,926**	**485,505**	**465,077**	**404,897**	**374,908**
Liabilities					
Due to banks	15,858	3,350	14,910	24,595	9,446
Derivative financial liabilities	85	814	268	519	121
Financial liabilities at amortised cost – Due to depositors	370,314	319,861	310,027	247,787	242,238
Financial liabilities at amortised cost – Due to other borrowers	81,146	69,589	46,847	47,308	47,414
Debt securities in issue	16,304	16,297	16,291	14,148	8,898
Retirement benefit obligation	592	689	643	561	409
Current tax liabilities	2,480	952	1,013	581	1,221
Deferred tax liability	–	–	244	–	–
Other liabilities	10,028	6,580	6,120	5,059	4,459
Subordinated term debt	18,400	18,387	19,357	16,860	16,855
Total liabilities	**515,205**	**436,519**	**415,720**	**357,418**	**331,061**
Equity					
Stated capital	13,182	8,600	7,682	7,530	4,716
Statutory reserve	2,875	2,747	2,584	2,462	2,358
Retained earnings	22,601	22,092	19,652	18,228	17,187
Other reserves	12,063	15,547	19,439	19,259	19,585
Total equity	**50,721**	**48,986**	**49,357**	**47,480**	**43,846**
Total equity and liabilities	**565,926**	**485,505**	**465,077**	**404,897**	**374,908**
Contingent liabilities and commitments	**169,133**	**148,132**	**130,764**	**130,590**	**137,144**

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Annexue 1-Five year summary of Financial Statements (Bank) - Cont.

Description	Years ended 31st December				
	2022 (Rs. Mn)	2021 (Rs. Mn)	2020 (Rs. Mn)	2019 (Rs. Mn)	2018 (Rs. Mn)
Statement of Changes in Equity					
Balance as at the Beginning of the year	**48,986**	**49,357**	**47,480**	**43,846**	**47,877**
Surcharge Tax Paid	(1,232)	-	-	-	-
Adjustment on initial application of SLFRS 9, net of tax	-	-	-	-	(2,533)
Restated balance as at the Beginning of the year	47,754	-	-	-	45,344
Profit for the year	2,513	3,222	2,388	2,074	2,768
Other comprehensive (expenses)/income, net of tax	(3,133)	(3,602)	243	(325)	(2,882)
Total comprehensive (expenses)/ income for the year	**(620)**	**(381)**	**2,631**	**1,749**	**(114)**
Transfer of gains/(losses) on disposal/write-off of equity investments at fair value through other comprehensive income to retained earnings	-	-	-	-	(63)
Rights issue	3,584	-	-	2,805	-
Forfeiture of unclaimed dividends	3	10	7	6	5
Transactions with equity holders of the Bank, recognised directly in equity	-	-	-	-	-
Forfeiture of unclaimed dividends	-	-	-	-	0
Final dividend approved	-	-	(760)	(928)	(1,325)
Total contributions from and distribution to equity holders	**3,587**	**10**	**(754)**	**1,884**	**(1,320)**
Balance at the end of the year	**50,721**	**48,986**	**49,357**	**47,480**	**43,846**

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Annexue 1-Five year summary of Financial Statements (Bank) - Cont.

Description	Years ended 31st December				
	2022 (Rs. Mn)	2021 (Rs. Mn)	2020 (Rs. Mn)	2019 (Rs. Mn)	2018 (Rs. Mn)
Statement of cash flows					
Operating cash flows before changes in operating assets and liabilities	12,849	2,503	(1,162)	(2,903)	1,974
(Increase)/decrease in operating assets: and operating liabilities:	33,093	(59,304)	33,625	(11,142)	17,544
Net cash flows (used in)/from operating activities before income tax	45,942	56,801	32,464	(14,045)	19,518
Surcharge tax paid	(1,232)	-	-	-	-
Income tax paid	(1,531)	(1,621)	(615)	(1,692)	(318)
Net cash flows (used in)/from operating activities	43,179	(58,422)	31,848	(15,737)	19,200
Net cash flows used in investing activities	(23,623)	41,760	(7,397)	(5,401)	(15,629)
Net cash flows from/(used in) financing activities	(5,185)	10,500	(6,928)	21,289	(8,904)
Net increase/(decrease) in cash and cash equivalents	14,371	(6,162)	17,523	151	(5,333)
Cash and cash equivalents at the beginning of year	16,976	23,139	5,615	5,465	10,798
Cash and cash equivalents at the end of year	31,347	16,976	23,139	5,615	5,465
Reconciliation of cash and cash equivalents with items reported in the statement of financial position					
Cash and cash equivalents	16,123	10,688	7,724	5,450	5,040
Placements with banks	15,225	6,288	15,414	165	425
Cash and cash equivalents at the end of year	31,347	16,976	23,139	5,615	5,465

Description	Years ended 31st December				
	2022 (Rs. Mn)	2021 (Rs. Mn)	2020 (Rs. Mn)	2019 (Rs. Mn)	2018 (Rs. Mn)
Debt / Equity Ratio (Times) **	2.51	1.85	2.06	2.03	1.88
Interest Cover Ratio (Times) ***	1.47	2.26	1.52	1.44	0.89
Capital adequacy - Core capital ratio % ****	10.09	9.31	10.82	11.342	10.766
Capital adequacy - Total capital ratio % ****	13.15	13.03	15.764	15.81	16.065

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Annexure 2 – The adoption of revised / new accounting standards and a summary of related amendments to the accounting policies of the Bank for the financial years ended 31st December 2018 to 2022

Financial year ended	Adoption of revised Accounting Standards and related changes in Accounting Policies
31st December 2018	**SLFRS 09 'Financial Instruments'**

Financial Assets

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.

2. Classification

2.1 Policy applicable after 1 January 2018

On initial recognition, the Bank classifies financial assets as measured at:

- Amortised cost,
- Fair value through other comprehensive income (FVOCI); and
- Fair value through profit or loss (FVTPL)

The subsequent measurement of financial assets depends on their classification.

2.1.1 Financial assets measured at amortised costs

A financial asset is measured at amortised cost if it meets both of the following conditions and is not designated as at FVTPL:
- The asset is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

2.1.2 Financial assets at fair value through other comprehensive income

A debt instrument is measured at FVOCI only if it meets both of the following conditions and is not designated as at FVTPL:

- The asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

On initial recognition of an equity investment that is not held for trading, the Bank may irrevocably elect to present subsequent changes in fair value in OCI. This election is made on an investment-by-investment basis.

2.1.3 Financial assets at fair value through profit or loss

All financial assets other than those classified at amortised costs or FVOCI are classified as measured at FVTPL.

- Financial assets are mandatorily fair valued through profit and loss when the Instruments are held for trading, or
- are managed, evaluated and reported internally on a fair value basis, or
- designation eliminates or significantly reduces an accounting mismatch which would otherwise arise, or
- contains an embedded derivative that significantly modifies the cash flows which would otherwise have been required under the contract.

2.1.3.1 Financial assets designated at fair value through profit or loss

In addition, on initial recognition, the Bank may irrevocably designate a financial asset that otherwise meets the requirements to be measured at amortised cost or at FVOCI or at FVTPL if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

The Bank has not designated any financial asset upon initial recognition at fair value through profit or loss as at the reporting date.

2.2 Business model assessment

The Bank makes an assessment of the objective of a business model in which an asset is held at a portfolio level because this best reflects the way the business is managed and information is provided to the Management. The information considered includes:

- the stated policies and objectives for the portfolio and the operation of those policies in practice. In particular, whether Management's strategy focuses on earning contractual interest revenue, maintaining a particular interest rate profile, matching the duration of the financial assets to the duration of the liabilities that are funding those assets or realising cash flows through the sale of the assets;
- how the performance of the portfolio is evaluated and reported to the Bank's Management;
- the risks that affect the performance of the business model (and the financial assets

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held within that business model) and how those risks are managed;
- how managers of the business are compensated – e.g. whether compensation is based on the fair value of the assets managed or the contractual cash flows collected; and
- the frequency, volume and timing of sales in prior periods, the reasons for such sales and its expectations about future sales activity. However, information about sales activity is not considered in isolation, but as part of an overall assessment of how the Bank's stated objective for managing the financial assets is achieved and how cash flows are realised.

Financial assets that are held for trading or managed and whose performance is evaluated on a fair value basis are measured at FVTPL because they are neither held to collect contractual cash flows nor held both to collect contractual cash flows and to sell financial assets.

2.3 Assessments whether contractual cash flows are solely payments of principal and interest

For the purposes of this assessment, "principal" is defined as the fair value of the financial asset on initial recognition. "Interest" is defined as consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs, as well as profit margin.

In assessing whether the contractual cash flows are solely payments of principal and interest, the Bank considers the contractual terms of the instrument.

This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition.

In making the assessment, the Bank considers:
- contingent events that would change the amount and timing of cash flows;
- leverage features;
- prepayment and extension terms;
- terms that limit the Bank's claim to cash flows from specified assets; and
- features that modify consideration of the time value of money.

2.4 Policy applicable before 1 January 2018

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.

3. Reclassification

Policy applicable after 1 January 2018

Financial assets are not reclassified subsequent to their initial recognition, except and only in those rare circumstances when the Bank's changes its objective of the business model for managing such financial assets. Financial Liabilities are not reclassified as such reclassifications are not permitted by SLFRS 9.

3.1 Timing of reclassification of financial assets

Consequent to the change in the business model, the Bank reclassifies all affected assets prospectively from the first day of the next reporting period (the reclassification date). Prior periods are not restated.

3.2 Measurement of reclassification of financial assets

3.2.1 Reclassification of financial instruments at "fair value through profit or loss"

- **To Fair value through other comprehensive income**
  The fair value on reclassification date becomes the new gross carrying amount. The EIR is calculated based on the new gross carrying amount. Subsequent changes in the fair value are recognised in OCI.

- **To amortised costs**
  the fair value on reclassification date becomes the new carrying amount. The EIR is calculated based on the new gross carrying amount.

3.2.2 Reclassification of financial instruments at "fair value through other comprehensive income"

- **To fair value through profit or loss**

  The accumulated balance in OCI is reclassified to profit and loss on the reclassification date.

- **To amortised costs**

The financial asset is reclassified at fair value. The cumulative balance in OCI is

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removed and is used to adjust the reclassified fair value. The adjusted amount becomes the amortised cost. EIR determined at initial recognition and gross carrying amount are not adjusted as a result of reclassification.

3.2.3 Reclassification of financial instruments at "amortised costs"

- **To Fair value through other comprehensive income**

The asset is remeasured to fair value, with any difference recognised in OCI. EIR determined at initial recognition is not adjusted as a result of reclassification.

- **To Fair value through profit or loss**

The fair value on the reclassification date becomes the new carrying amount. The difference between amortised cost and fair value is recognised in profit and loss.

Policy applicable before 1 January 2018

The bank classified its financial assets into one of the following categories:
Loans and receivable

- Held-to-maturity
- Available for sale and
- At FVTPL, and within this category as:
  - held-for-trading: or
  - designated as at FVTPL

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.

From 1 January 2018 any cumulative gain/loss recognised in OCI in respect of equity investment securities designated as at FVOCI is not recognised in profit or loss on derecognition of such securities. Any interest in transferred financial assets that qualify for derecogntion that is created or retained by the group is recognised as a separate asset or liability.

3.5 Modifications of financial assets and financial liabilities

Policy applicable from 1 January 2018

Financial assets

If the terms of a financial asset are modified, then the Bank evaluates whether the cash flows of the modified asset are substantially different.

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If the cash flows are substantially different, then the contractual right to cash flows from the original financial asset are deemed to have expired. In this case, the original financial asset is derecognised and new financial asset is recognised at fair value plus any eligible transaction cost. Any fees received as part of the modification are accounted as follows:

- Fees that are considered in determining the fair value of the new asset and fees that represent reimbursement of eligible transaction costs are included in the initial measurement of the asset; and
- Other fees are included in profit or loss as part of the gain or loss on the derecognition.

If cash flows are modified when the borrower is in financial difficulty, then the objective of the modification is usually to minimise recovery of the original contractual term rather than to originate a new asset with substantially different terms. If the Bank plans to modify a financial asset in a way that would result in forgiveness of cash flows, then it first considers whether a portion of the asset should be written off before the modification takes place. This approach impacts the result of the quantitative evaluation and means that the derecognition criteria are not usually met in such cases.

If the modification of a financial asset measured at amortised cost or FVOCI does not result in derecognition of the financial asset, then the Bank first recalculates a gross carrying amount of the financial asset using the original effective interest rate of the asset and recognizes the resulting adjustment as modification gain or loss in profit or loss. For floating- rate financial asset, the original effective interest rate used to calculate the modification gain or loss is adjusted to reflect current market terms at the time of modification. Any costs or fees incurred and fees received as part of the modification adjust the gross carrying amount of the modified financial asset and are amortised over the remaining term of the financial asset.

3.6 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 nonperformance 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.

3.7 Identification and measurement of impairment

3.7.1 Policy applicable after 1 January 2018

7.1.1 Recognition of impairment of financial assets

The Bank recognises loss allowances for Expected Credit Losses (ECL) on the following financial instruments that are not measured at FVTPL:

- Financial assets that are debt instruments;
- Lease receivables;
- Financial guarantee contracts issued; and
- Loan commitments issued.

No impairment loss is recognised on equity investments.

The Bank measures loss allowances at an amount equal to lifetime ECL, except for the following, for which they are measured as 12-month ECL:
- Debt investment securities that are determined to have low credit risk at the reporting date; and
- other financial instruments (other than lease receivables) on which credit risk has not increased significantly since their initial recognition.

The Bank considers a debt security to have low credit risk when their credit risk rating is equivalent to the globally understood definition of "investment grade". 12-month ECL are the portion of ECL that result from default events on a financial instrument that are

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possible within the 12 months after the reporting date.

7.1.2 Presentation of allowance for ECL in the statement of financial position

- Loss allowances for ECL are presented in the statement of financial position as follows:
- Financial assets measured at amortised cost: as a deduction from the gross carrying amount of the assets;
- Loan commitments and financial guarantee contracts: generally, as a provision;
- Where a financial instrument includes both a drawn and an undrawn component, and the Bank cannot identify the ECL on the loan commitment component separately from those on the drawn component: the Bank presents a combined loss allowance for both components: The combined amount is presented as a deduction from the gross carrying amount of the drawn component. Any excess of the loss allowance over the gross amount of the drawn component is presented as a provision; and

- Debt instruments measured at FVOCI: no loss allowance is recognised in the statement of financial position because the carrying amount of these assets is their fair value. However, the loss allowance is disclosed and is recognised in the fair value reserve.

7.2 Policy applicable before 1 January 2018

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.

7.2.1 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 Bank or economic conditions that correlate with defaults in the Bank.

7.2.2 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.

7.2.3 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.

7.2.4 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.

8 Offsetting

Financial assets and financial liabilities are off set 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 SLFRSs/LKASs or for gains and losses arising from a group of similar transactions.

9 Fiduciary assets

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

10 Write-off of financial assets

The Bank writes off a loan or an investment debt security, and any related allowances for impairment losses, when Bank determines that the loan or security is uncollectible. This determination is made after considering information such as the occurrence of significant changes in the borrower's/issuer's financial position such that the borrower/issuer can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure. For smaller balance standardised loans, write-off decisions generally are based on a product-specific past due status.

Financial liabilities

1. Recognition and measurement of financial liabilities

Policy applicable after 1 January 2018

On initial recognition, the Bank classifies financial liabilities, other than financial guarantees and loan commitments, into one of the following categories:

- Financial liabilities at amortised cost; and
- Financial liabilities at fair value through profit or loss,

Policy applicable before 1 January 2018

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.

2. Classification and subsequent measurement of financial liabilities

The subsequent measurement of financial liabilities depends on their classification.

2.1 Financial liabilities at amortised cost

Financial Liabilities issued by the Bank that are not designated at fair value through profit or loss are recognised initially at fair value plus any directly attributable transaction costs, by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the EIR. Subsequent to initial recognition these financial liabilities are measured at amortised cost using the effective interest method. Deposit liabilities including savings deposits, current deposits, fixed/time deposits, call deposits, certificates of deposit and debentures are classified as financial liabilities measured at amortised cost.

The EIR amortisation is included in "Interest expense" in the income statement. Gains and losses too are recognised in the income statement when the liabilities are derecognised as well as through the EIR amortisation process.

2.2 Financial liabilities at fair value through profit or loss

Financial liabilities at fair value through profit or loss include derivative liabilities held for risk management purposes.

3 Derecognition of Financial Liabilities

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

4 Due to Banks, customers, debt securities issued and other borrowing

Financial liabilities are recognised when Bank 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 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

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obligation.

6 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 "Financial assets at amortised cost – Loans to and receivables from banks", "Financial assets at amortised cost – Loans to and receivables from other 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.

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 applied 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 replaced existed revenue recognition guidance, including LKAS 18 - "Revenue" and LKAS 11 "Construction Contracts" and IFRIC 13 - "Customer Loyalty Programs".

The Group/Bank adopted this standard from 15th January 2018 and did not have significant impact on its financial statements resulting from the application of SLFRS 15.

31st December 2019 **SLFRS 16 - 'Leases'**

The Bank has applied SLFRS 16 using the modified retrospective approach and therefore the comparative information has not been restated and continues to be reported under LKAS 17 and IFRIC 4. The details of accounting policies under LKAS 17 and IFRIC 4 are disclosed separately.

Policy applicable from 1 January 2019

At inception of a contract, the Bank assesses whether a contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. To assess whether a contract conveys the right to control the use of an identified asset, the Bank uses the definition of a lease in SLFRS 16.

This policy is applied to contracts entered into, on or after 1 January 2019.

As a lessee
At commencement or on modification of a contract that contains a lease component, the Bank allocates the consideration in the contract to each lease component on the basis of its relative stand-alone prices. However, for the leases of property the Bank has elected not to separate non-lease components and account for the lease and non-lease components as a single lease component.

The Bank recognises a right-of-use asset and a lease liability at the lease commencement date. The right-of-use asset is initially measured at cost, which comprises the initial amount of the lease liability adjusted for any lease payments made or payable at or before the commencement date, plus any initial direct costs incurred and an estimate of costs to dismantle and remove the underlying asset or to restore the underlying asset or the site on which it is located, less any lease incentives received.

The right-of-use asset is subsequently depreciated using the straight-line method from the commencement date to the end of the lease term, unless the lease transfers ownership of the underlying asset to the Bank by the end of the lease term or the cost of the right-of-use asset reflects that the Bank will exercise a purchase option. In that case the right-of-use asset will be depreciated over the useful life of the underlying asset, which is determined on the same basis as those of property, plant and equipment.

In addition, the right-of-use asset is periodically reduced by impairment losses, if any, and adjusted for certain remeasurements of the lease liability.

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the Bank's incremental borrowing rate.
Generally, the Bank uses its incremental borrowing rate as the discount rate.

The bank determines its incremental borrowing rate by obtaining interest rates from the Bank's internal records (weighted average cost of funds) to reflect the terms of the lease and type of the asset leased.

Lease payments included in the measurement of the lease liability comprise the following:
– fixed payments, including in-substance fixed payments;
– variable lease payments that depend on an index or a rate, initially measured using the index or rate as at the commencement date;
– amounts expected to be payable under a residual value guarantee; and
– the exercise price under a purchase option that the Bank is reasonably certain to exercise, lease payments in an optional renewal period if the Bank is reasonably certain to exercise an extension option, and penalties for early termination of a lease unless the Bank is reasonably certain not to terminate early.

The lease liability is measured at amortised cost using the effective interest method. It is remeasured when there is a change in future lease payments arising from a change in an index or rate, if there is a change in the Bank's estimate of the amount expected to be payable
under a residual value guarantee, if the Bank changes its assessment of whether it will

exercise a purchase, extension or termination option or if there is a revised in-substance fixed lease payment.

When the lease liability is remeasured in this way, a corresponding adjustment is made to the carrying amount of the right-of-use asset, or is recorded in profit or loss if the carrying amount of the right-of-use asset has been reduced to zero.

Short-term leases and leases of low-value assets

The Bank has elected not to recognise right-of-use assets and lease liabilities for leases of low-value assets and short-term leases. The Bank recognises the lease payments associated with these leases as an expense on a straight-line basis over the lease term.

As a lessor

At inception or on modification of a contract that contains a lease component, the Bank allocates the consideration in the contract to each lease component on the basis of their relative standalone prices.

When the Bank acts as a lessor, it determines at lease inception whether each lease is a finance lease or an operating lease.

To classify each lease, the Bank makes an overall assessment of whether the lease transfers substantially all of the risks and rewards incidental to ownership of the underlying asset. If this is the case, then the lease is a finance lease; if not, then it is an operating lease.

As part of this assessment, the Bank considers certain indicators such as whether the lease is for the major part of the economic life of the asset.

When the Bank is an intermediate lessor, it accounts for its interests in the head lease and the sub-lease separately.

It assesses the lease classification of a sub-lease with reference to the right-of-use asset arising from the head lease, not with reference to the underlying asset. If a head lease is a short-term lease to which the Bank applies the exemption described above, then it classifies the sub-lease
as an operating lease.

If an arrangement contains lease and non-lease components, then the Bank applies SLFRS 15 to allocate the consideration in the contract.

The Bank applies the derecognition and impairment requirements in SLFRS 9 to the net investment in the lease. The Bank further regularly reviews estimated unguaranteed residual values used in calculating the gross investment in the lease.

The Bank recognises lease payments received under operating leases as income on a straightline basis over the lease term as part of "other revenue".

Generally, the accounting policies applicable to the Bank as a lessor in the comparative period were not different from SLFRS 16.

Policy applicable prior to 1 January 2019

Determining whether an Arrangement Contains a Lease
At inception of an arrangement, the Bank determines whether the arrangement is or contains a lease.

At inception or on reassessment of an arrangement that contains a lease, the Bank separates payments and other consideration required by the arrangement into those for the lease and those for other elements on the basis of their relative fair values. If the Bank concludes for a finance lease that it is impracticable to separate the payments reliably, then an asset and a liability are recognised at an amount equal to the fair value of the underlying asset; subsequently, the liability is reduced as payments are made and an imputed finance cost on the liability is recognised using the Bank's incremental borrowing rate.

Leased Assets

Leases of property, plant and equipment that transfer to the Bank substantially all of the risks and rewards of ownership are classified as finance leases. The leased assets are measured initially at an amount equal to the lower of their fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the assets are accounted for in accordance with the accounting policy applicable to that asset. Assets held under other leases are classified as operating leases and are not recognised in the Bank's statement of financial position.

Lease Payments
Payments made under operating leases are recognised in profit or loss on a straight-line basis over the term of the lease. Lease incentives received are recognised as an integral part of the total lease expense, over the term of the lease. Contingent rents, if any, are recognised as
revenue in the period in which they are earned.

Minimum lease payments made under finance leases are apportioned between the finance expense and the reduction of the outstanding liability. The finance expense is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability

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31st December 2020 **SLFRS 3 - 'Business Combinations'**

The Bank has initially adopted Definition of a Business (Amendments to SLFRS 3) from 1 January 2020 to business combinations whose dates of acquisition are on or after 1 January 2020 in assessing whether it had acquired a business or a group of assets.

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Annexure 2 – The adoption of revised / new accounting standards and a summary of related amendments to the accounting policies of the Bank for the financial years ended 31st December 2018 to 2022 - Cont.

31st December 2021	**Interest Rates Benchmark Reform -Phase 2 (Amendments to SLFRS 9, LKAS 39, LKAS 39, SLRFS 7)** Interest Rates Benchmark Reform -Phase 2 (Amendments to SLFRS 9, LKAS 39, SLRFS 7 become effective on 1 January 2021.

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