

## Board Audit Committee Report

### Composition of the Committee

The Committee is appointed by the Board and as at the end of the year comprised of the following Non-Executive Directors of the Bank:

Mr. S. Swarnajothi (*Chairman*)  
 Mr. L. Hulugalle (*Director*)  
 Mr. K.M.M. Siriwardana (*Director*)\*

\*(Ceased to hold office w.e.f. February 23, 2015)

The Chairman of the Committee, Mr. S. Swarnajothi, an Independent Non-Executive Director, is a former Auditor General of Sri Lanka and possesses considerable experience in the field of Auditing and Finance. He is a Fellow of The Institute of Chartered Accountants of Sri Lanka (FCA) and a Fellow of the Institute of Certified Management Accountants of Sri Lanka (FCMA).

Other members of the Committee, namely, Messrs. L. Hulugalle and K.M.M. Siriwardana are also Independent Non-Executive Directors.

The profiles of the members are given on pages 129 to 131.

Mr. Manil Jayasinghe serves the Committee in the capacity of a Consultant and is invited to attend its meetings. He is a practicing senior Chartered Accountant with long years of experience in Auditing, Accounting Standards and Financial Reporting.

Assistant General Manager of the Bank, in charge of Management Audit, functions as the Secretary of the Committee.

### Charter of the Committee

The Audit Committee Charter is periodically reviewed and revised with the concurrence of the Board of Directors. The Terms of Reference of the Committee are clearly defined in the Charter of the Audit Committee. This process ensures that new developments and concerns are adequately addressed. The Committee is responsible to the Board of Directors and reports on its activities regularly. The functions of the Committee are geared to assist the Board of Directors in its general oversight on financial reporting, internal audit, internal controls and external audit.

The Banking Act Direction No. 11 of 2007 (hereinafter referred as the Direction) on 'Corporate Governance for Licensed Commercial Banks in Sri Lanka' and its subsequent amendments, '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 Board Audit Committee.

### Conduct of Meetings

The Committee held eight meetings during the financial year ended December 31, 2014. The proceedings of these meetings, with adequate details of matters discussed, are regularly reported to the Board of Directors. Managing Director, Chief Operating Officer, Chief Financial Officer, Chief Risk Officer, Compliance Officer and Assistant General Manager - Management Audit attended the Committee meetings by invitation. Representatives of the Bank's External Auditors M/s. KPMG also participated in five 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 based on necessity.

The attendance of Committee members is stated in the table appearing on page 153.

### The Objective and Role

The Audit Committee assists the Board of Directors to effectively carry out its supervisory oversight responsibilities on accounting and financial reporting processes and the audit of the Financial Statements of the Bank. The Committee is empowered to -

- Examine any matter relating to the financial and other connected affairs of the Bank.
- Ensure that efficient and sound financial reporting systems are in place and are well-managed in order to provide accurate, appropriate and timely information to the Board of Directors, Regulatory Authorities, the Management and other Stakeholders.
- Review the quality and the appropriateness of accounting policies and their adherence to statutory and regulatory compliance requirements and applicable Accounting Standards.
- Ensure that the Bank has adopted and adhere to policies which firmly commits the Bank to achieve the highest standards of good Corporate Governance practices so that its operations conform to the highest ethical standards, good industry practices and in the best interest 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 internal and external audit and inspection programmes, review internal and external audit/inspection reports and follow up 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 of Directors.

The Bank has complied with the requirements specified in the Section 3(6)(ii) of the aforesaid Direction. The Committee's functions in discharging the above responsibilities have more fully been described below:

### Reporting of Financial Position and Performance

The Board Audit Committee supports the Board of Directors in its oversight on the preparation of Financial Statements that evidence a true and fair view on financial position and performance, based on the Bank's accounting records and in accordance with the stipulated requirements of the Sri Lanka Accounting Standards. In accordance with the mandate mentioned above, the Committee reviews the following:

- Adequacy and effectiveness of the Internal Controls, Systems and Procedures to provide reasonable assurance that all transactions are accurately and completely recorded in the books of account.
- Effectiveness of the Financial Reporting Systems in place to ensure reliability of the information provided to the stakeholders.
- Selection of most appropriate Accounting Policies after considering the alternatives available.
- Processes by which compliance with Sri Lanka Accounting Standards (SLFRS/LKAS) and other regulatory provisions relating to financial reporting and disclosures are ensured.
- Financial Statements in Annual Report and Interim Financial Statements prepared for publication, prior to submission to the Board.

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

### Oversight on Regulatory Compliance

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

### Identification of Risks and Control Measures

In view of the fact that the Bank has adopted a risk-based audit approach, 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 operational risks identified during inspections. The Committee seeks and obtains the required assurances from the Business Units on the remedial action in respect of the identified risks in order to maintain the effectiveness of internal control procedures in place.

### Internal Audit and Inspection

The Committee ensures that the Internal Audit function is independent of the activities it audits and that it is 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 Bangladesh operations. With the concurrence of the Board of Directors, the Bank continues to engage the services of five firms of Chartered Accountants approved by the Central Bank of Sri Lanka in order to supplement Bank's Inspection Department in carrying out such inspections.

The Committee regularly reviews the programme of inspection formulated for the purpose and its implementation and closely monitors the internal audit and the inspection functions. 616 inspection reports on Branches, other Business Units and Departments received the attention of the Committee and the operational deficiencies, lapses highlighted and the recommendations were given due attention. Members of the Committee visited some of the branches to get a better understanding of the branch operations. 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.

### External Audit

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

- Assisting the Board of Directors to implement the processes of 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.
- Monitor and assess the independence of the External Auditor.

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- 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 with the Auditors their audit plan, scope and the methodology proposed to be adopted in conducting the audit 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 the Key Management Personnel.
- Reviewing the External Auditor's Management Letter and the management's response thereto.

The Auditors were also provided with the opportunities of meeting the 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 and also for the Committee to have the assurance 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 Auditor's Management Letter before it is submitted to the Board of Directors and to the Central Bank of Sri Lanka.

### 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 Auditors 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 monitors 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 nonperforming loans and provisioning requirements specified by the Central Bank of Sri Lanka. 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 are ensured. All appropriate procedures are 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

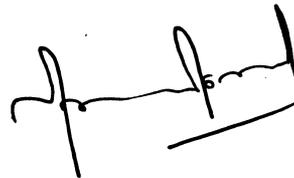
The Committee continued to monitor the progress of the mandatory implementation of Sri Lanka Accounting Standards (SLFRS/LKAS) which converged with International Financial Reporting Standards (IFRS) effective from January 1, 2012.

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 of Directors.

The Committee would continue to monitor the compliance with relevant Accounting Standards and keep the Board of Directors 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 23, 2015