

Report of the Audit Committee

The Board Audit Committee comprises of three Independent Non-Executive Directors and one Non-Executive Director. The Committee is chaired by P M B Fernando, who is a fellow member of the Institute of Chartered Accountants and possesses considerable experience in the fields of Finance and Auditing.

The members of the Board appointed Audit Committee are as follows:

- P M B Fernando - Chairman
- L N De S Wijeyeratne
- T Dharmarajah
- K D N R Asoka

Profiles of the members are given in pages 12 to 13.

Meetings

The Head of Group Internal Audit, functioned as the Secretary to the Committee for the year-ended 31 December 2016. During the year, 14 Audit Committee Meetings were held and proceedings of the Audit Committee Meetings were reported regularly to the Board.

Attendance by the Committee members at the meetings is given in the table on page 98 of this Annual Report.

The Chief Executive Officer, Chief Financial Officer and Chief Operating Officer attend meetings by invitation. Senior Management also attend the meetings on invitation in order to brief the Audit Committee on specific matters. The Committee held two meetings with the External Auditor; KPMG independently, without the presence of executive management, to discuss the progress and conclusion of the Audit.

Mandate and Role

The Terms of Reference of the Committee, which is subject to review periodically by the Board of Directors, clearly defines the mandate and role of the Committee. The Committee is responsible to the Board of Directors and reports on its activities regularly. The Committee assists the Board of Directors in fulfilling its general oversight of financial reporting, internal controls, internal and external audits.

The Committee has discharged the responsibilities assigned by Rule No. 3(6) (ii) of the Corporate Governance Direction No. 11 of 2007, issued by the Central Bank of Sri Lanka. Where appropriate, more details are provided under separate headings in this Report.

Financial Reporting

The Committee reviews effectiveness of the Financial Reporting System in place, to ensure reliability of information provided to the stakeholders. The Committee reviews that to the best of its knowledge and belief, the financial statements issued for external purposes by DFCC Bank PLC (Bank), complied with generally accepted principles of accounting as enunciated in Sri Lanka Accounting Standards, and complies with the statutory provisions of Companies Act No. 07 of 2007 and Banking Act No. 30 of 1988, and subsequent amendments thereto.

The Committee assists the Board of Directors to discharge their responsibility for the preparation of true and fair financial statements in accordance with the books of accounts and Sri Lanka Accounting Standards. The Committee reviews the adequacy and effectiveness of the internal control system and procedures to provide reasonable assurance that all transactions are accurately and completely recorded in the books of accounts. In accordance with the mandate, the Committee reviewed and discussed with the management and internal/external Auditors on the critical accounting policies, practices, related changes thereto, alternative accounting treatments, major judgment areas, material audit adjustments, compliance with accounting standards, going concern assumptions, financial reporting controls and compliance with applicable laws and regulations that could impact the Bank's financial statements, its Annual Report and its quarterly financial statements prepared for publication.

The Committee reviewed all quarterly non-audited interim financial statements and financial statements for the year-ended 31 December 2016, together with supporting information that included significant assumptions and judgments made in the preparation of financial statements. The Committee also took into consideration the Internal Audit reports, management letter issued by the External Auditor and the responsibility statements in relation to the financial statements issued by the Chief Financial Officer and Chief Executive Officer in making an overall assessment on the integrity of the Financial Reporting system.

The Committee also discussed the operations and future prospects of the Bank with management regularly and is satisfied that all relevant matters have been taken into account in the preparation of the financial statements and that the 2016 financial statements are reliable and presents a true and fair view of the state of affairs of the Bank.

Internal Controls

The Audit Committee assessed the effectiveness of internal control over financial reporting as at 31 December 2016 as required to comply with section 3(8) (ii) (b) of the Banking Act Direction No. 11 of 2007 on Corporate Governance for Licensed Commercial Banks, issued by the Central Bank of Sri Lanka. This process assesses the adequacy and effectiveness of the internal controls and the processes for controlling business risks to ensure compliance with laws and regulations. The Committee ensures that appropriate action is taken by the management on the recommendations of the Internal Auditors to improve the effectiveness of the internal control system of the Bank. The Board of Directors performs its responsibilities on the basis of the internal control framework, which enables the Board to pursue its functions and take necessary measures. The Board's statement on effectiveness of the Bank's internal control mechanism is published on pages 122 and 123.

Internal Audit

The Audit 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 Audit Charter authorises and guides the Head of Group Internal Audit (HGIA) in carrying out the independent audit function of the Bank and its subsidiaries. The HGIA enjoys operational independence in conducting duties and has the authority to initiate, carry out and report on any action, which is considered necessary. For the performance of duties, the HGIA and audit staff shall have unrestricted, unlimited, direct and prompt access to all records of the Bank and subsidiaries, officials or personnel holding any contractual status of the Bank and its subsidiaries and to all the premises of the Bank and its subsidiaries. The Audit Committee monitored and reviewed the scope, resources, extent and effectiveness of the activities of the Bank's Internal Audit Department.

With the concurrence of the Board of Directors, the Audit Committee engaged the services of two firms of Chartered Accountants to supplement the Bank's Internal Audit function in carrying out periodic audits at certain branches and few other assignments for the period ended 31 December 2016. The outsourced Internal Audit function is supervised by the Head of Internal Audit of the Bank and a representative of outsourced bodies participates for Audit Committee meetings by invitation.

The Committee reviewed the progress of the risk based audits carried out in accordance with the Internal Audit plan approved by the Committee for the year 2016. During the year, the Internal Audit Department has reviewed business lines, critical operational processes, risk and compliance functions, branches and subsidiary operations. Further, the department has conducted thematic audits focusing on particular audit objectives across the audited units/branches. The department formed a Potential Fraud Monitoring Unit under Internal Audit to carry out testing and data analytics related to potential fraud risk areas on a continuous basis.

The Internal Audit Department suggested simplified and efficient business processes where it was deemed necessary. In 2016, the Board Audit Committee reviewed audit reports of branches and departments, IS Audits, Thematic Audits and special investigations of the Bank. The Committee reviewed the Internal Audit reports of the Bank's subsidiaries as well.

The Committee had necessary interactions with the Head of Internal Audit throughout the year. The Board Audit Committee advised Corporate Management to take precautionary measures on significant audit findings. The Committee reviewed the structure, resources and performance of the Bank's Internal Audit Department at the year-end.

External Audit

The Committee reviewed and monitored the External Auditors' independence and objectivity and the effectiveness of the audit process, taking into consideration relevant professional and regulatory requirements. The Committee approved the policy in place on Non-Audit Services provided by the External Auditors.

The Committee discussed with the Auditors their audit plan, scope and the methodology they propose to adopt in conducting the annual audit prior to its commencement. The Auditors were also provided with opportunities to meet the Audit Committee separately, without the presence of executive management, to ensure that the Auditors had the independence to discuss and express their opinions on any matter. There was no limitation of scope and the management has fully provided all information and explanations requested by the Auditors. The Committee also met the Auditors to review the management letter with responses from the management.

The Audit Committee has recommended to the Board of Directors that KPMG Chartered Accountants be reappointed for the financial year-ending 31 December 2017, subject to the approval of shareholders at the next Annual General Meeting.

Whistleblowing Policy

The Whistleblowing Policy of the Bank and its subsidiaries was reviewed and recommended by the Audit Committee during the year 2016 in order to further strengthen the policy as a communication channel to raise any genuine concerns. The Committee continuously emphasised on sustaining ethical conduct amongst staff members. In this regard, a Code of Ethics and Whistleblowing Policy was put in place and all members of staff were educated and encouraged to practice whistleblowing if they suspect any wrong doing. All appropriate procedures and techniques are in place to conduct independent investigations into incidents reported through whistleblowing or identified through other channels. The Whistleblowing Policy guarantees the maintenance of strict confidentiality of the identity of whistleblowers. The Policy is subject to annual review in order to further improve its effectiveness.

Evaluation

The effectiveness of the Committee is self-evaluated annually by its members. An independent evaluation of the effectiveness of the Committee was carried out by the other members of the Board and the Committee, has been found to be effective.



P M B Fernando

Chairman - Audit Committee

20 February 2017

Report of the Human Resources and Remuneration Committee

The Composition

The Human Resources and Remuneration Committee appointed by the Board of Directors, presently consists of three Non-Executive Directors. C R Jansz is the Chairman of the Committee. Ms V J Senaratne and Ms S R Thambiayah are the other members. A W Atukorala also functioned as a member of the Committee until his resignation in August 2016.

The Chief Executive Officer attended meetings by invitation and participated in its deliberations, except when his own evaluation and remuneration were under discussion. He also serves as the Secretary. The Group Vice-President, Human Resources assisted the Committee by providing relevant information. The Committee obtains input from external specialists as and when required.

The Mandate

The Committee adopted as its mandate the tasks specified in Section 3(6) (iii) of Direction No. 11 of 2007 of the Central Bank of Sri Lanka on Corporate Governance for Licensed Commercial Banks. During the year, the Terms of Reference of the Committee was formally adopted by the Board.

The Committee, in determining the remuneration policy relating to Directors, Chief Executive Officer and Key Management Personnel of DFCC Bank PLC (Bank), in terms of Directions, ensures appropriate compensation levels in order to attract, retain and motivate talented staff with core capabilities matched to its strategy and also to ensure that the Bank consistently delivers value to all stakeholders and to make the organisation more competitive. To achieve this, the Committee uses a mix of fixed and variable pay to reward employees.

The Procedure

Apart from the general review of remuneration, in keeping with the policy of pay for performance, the Committee reviewed the performance of the Bank against the historical performance, key performance indicators agreed at the beginning of the year as well as against a peer group when determining and recommending to the Board, the annual salary increment pool and the performance based variable pay pool for the Bank. The Committee also appraised the performance of the Chief Executive Officer, based on the pre-agreed targets and desired skills, and reviewed his remuneration.

In addition, the Committee considers and recommends to the Board of Directors from time to time, the requirements of new expertise/skills and also salary revisions. The Committee periodically assesses the succession plan for key management positions and took appropriate steps to induct external skills to strengthen the management of the Bank where it was deemed necessary.

Meetings

The Committee held five meetings during the financial year to carry out its tasks. The attendance by members is given on page 98 of the Annual Report.



C R Jansz
Chairman -
Human Resources and Remuneration Committee
20 February 2017

Report of the Nomination and Governance Committee

Composition

The Nomination and Governance Committee of the Board of Directors consists of three Non-Executive Directors. P M B Fernando, an independent Director, is the Chairman with C R Jansz and K P Cooray, serving as members. A W Atukorala also functioned as a member of the Committee until his resignation in August 2016.

The Chief Executive Officer (CEO) attends the meeting by invitation, while the Secretary to the Board functions as the Secretary of the Committee.

Mandate

During the year under review, the Nomination Committee was replaced with the Nomination and Governance Committee. Accordingly, the Terms of Reference of the Committee was enhanced and the revised terms of Reference was adopted by the Board. The Terms of Reference encompass the tasks set out in Section 3(6) (iii) of Direction No. 11 of 2007 of the Central Bank of Sri Lanka on Corporate Governance in Licensed Commercial Banks. The Committee carried out the tasks in-line with the Terms of Reference which was adopted by the Board. In terms of the mandate, the role of the Committee is to review governance policies and procedures, evaluate the performance of the Board and identify and evaluate persons with the required skills, knowledge, standing, fitness and propriety to join the Board of the Bank and to evaluate the suitability of Directors who are seeking re-election. The Committee is also responsible for the task of putting in place, a procedure for the appointment of the CEO and Key Management Personnel.

Procedure

The Committee meets when required and acts within its mandate approved by the Board of Directors and makes recommendations to the Board for consideration.

Meetings

Five meetings were held during the financial year. The Committee considered and recommended to the Board, the appointment of one new Director, identified possible candidates to fill key management positions, reviewed succession planning including the CEO succession and assessed the fitness and propriety of Directors and Key Management Personnel, in terms of the requirements of the Banking Act.

Individual Committee members do not participate in discussions in matters relating to them. The attendance by Directors at meetings is given on page 98 of the Annual Report. The Committee has recommended the re-election of the Directors offering themselves for re-election at the Annual General Meeting.



P M B Fernando

Chairman – Nomination and Governance Committee

20 February 2017

Report of the Board Integrated Risk Management Committee

Composition of Board Integrated Risk Management Committee (BIRMC)

During the financial year-ended December 2016, the composition of the Board Integrated Risk Management Committee (BIRMC) of DFCC Bank PLC (Bank) changed as recommended by the Board of Directors. C R Jansz, the Chairman of DFCC Bank PLC and the BIRMC, handed over responsibilities to L N de S Wijeyaratne (Non-Executive Director of DFCC Bank PLC) and appointed him as the new Chairman of the Committee from June 2016. Further, K D N R Asoka and H A Ariyaratne were appointed as members representing Non-Executive Directors, while A N Fonseka retired from the membership during the year.

The Committee comprises of four Non-Executive Directors and one Executive Director as at 31 December 2016. The Chief Risk Officer, who has the voting power, functions as the Secretary to the Committee. Heads of key functional areas such as lending, finance, treasury, operations, IT and internal audit attend the meetings on invitation. The voting members of the BIRMC as at 31 December 2016 was as follows:

- L N de S Wijeyaratne – Chairman/Non-Executive Director
- A R Fernando – Chief Executive Officer/Executive Director
- P M B Fernando – Non-Executive Director
- K D N R Asoka – Non-Executive Director
- H A Ariyaratne – Non-Executive Director
- P Gamage – Chief Risk Officer

Charter and the Responsibilities of the BIRMC

The approved Charter for the BIRMC stipulates authority, structure, responsibilities and tasks of BIRMC. As per its Charter, the primary responsibilities of BIRMC are to review and ensure;

- A. Integrity and adequacy of the risk management function of the Bank
- B. Adequacy of the Bank's capital and its allocation

- C. Risk exposures and risk profiles of the Bank are within acceptable parameters and to make recommendations to the Board of Directors on any action required;
- D. The adequacy and effectiveness of the management committees are reviewed through a set of defined tools.
- E. Availability of a comprehensive and updated set of risk policies and guidelines covering overall operations of the Bank and the Group.
- F. The compliance of the Group's operations with relevant laws, regulations and standards including the adherence to the CBSL Direction on Corporate Governance.

The process through which the BIRMC discharges its responsibilities, is detailed in the Risk Management section of this Annual Report.

BIRMC Meetings

The BIRMC meets on a quarterly basis. During the year, the Bank convened five BIRMC meetings including a special meeting in December 2016. The attendance of members is listed on page 98 of this Annual Report. The Committee continued to review policy frameworks, risk management strategies, risk capital position and key risk indicators at these meetings and was satisfied that the risk exposures of the Bank and the Group were being appropriately managed. During the financial year, the following key initiatives were achieved by the Committee.

- A. Reviewed and approved the Internal Capital Adequacy Assessment Process (ICAAP) of the Bank for the amalgamated entity, which was a regulatory requirement with effect from January 2014. BIRMC took several key decisions on the capital management, based on the outcome revealed by the ICAAP. They included strengthening of the Tier II capital by issuing subordinated debt in the last quarter and taking steps to enhance retained earnings by considering options such as a reducing dividend payout and issuing scrip dividends.
- B. In relation to the management of compliance risk, compliance risk indicators with different risk scales were reviewed and specific areas of focus were identified, based on the possible impact and the probability of occurrence.

- C. Risk controls and monitoring tools were further improved with revisions to the overall risk limits system of the Bank, from time to time, as required.
- D. The Committee approved the revisions of credit rating models for corporate exposures, subsequent to an external validation of the model. This revision focused on taking a better approach of recognise the borrower risk profile, and reducing the subjectivity in assigning the scores for the model parameters.
- E. The Committee reviewed the Probability of Default (PD), based on the rating grades, Loss Given Default (LGD) for facilities and technical validation results for the credit rating models. These credit risk parameters are used in the credit appraisal process, credit pricing and risk management.
- F. The annual review of effectiveness and adequacy of the management committees was conducted by the BIRMC.
- G. Reviewed and approved new products and redesigned existing products of the Bank, from a business and risk management perspective.
- H. Reviewed the CBSL recommendations based on the examination report requirements in relation to the integrated risk management function of the Bank.
- I. Having duly recognised the trends in increasing threats on systems and information security, the Committee increased its focus by reviewing the adequacy of the security in information systems and closely monitoring the action plans and implementation of new projects for further improving information systems security in the Bank.
- J. Reviewed Top and Emerging Risks on a monthly basis.
- K. All existing risk policies and practices were reviewed by the Committee, in line with the Bank's specific requirements, industry dynamics and regulatory specifications.

Reporting

The proceedings of the BIRMC meetings are reported to the Board through submission of the meeting minutes. Other specific matters are submitted separately for the Boards' approval on recommendation of the BIRMC. The recommendations made by the BIRMC during the year under review were approved by the Board.



L N de S Wijeyaratne

Chairman – Board Integrated Risk Management Committee

20 February 2017

Report of the Credit Approval Committee

The Composition

The Credit Approval Committee of the Board of Directors consists of three Non-Executive Directors. C R Jansz is the Chairman with T Dharmarajah and K P Cooray serving as members. A W Atukorala also functioned as a member of the Committee until his resignation in August 2016.

The Company Secretary functions as the Secretary of the Committee.

The Mandate

The Committee carried out the tasks set out in the Terms of Reference approved by the Board. The primary purpose of the Committee is to review and where appropriate, recommend or approve credit facilities which require approval above the delegated limit of the Management Credit Committee of the Bank.

The Procedure

The Committee meets at least once a month and as and when required. The Committee invites the relevant officers to these meetings to clarify issues and for discussions relating to proposals that are submitted for review, and also guides the management in improving the credit policies, procedures and process improvements for monitoring and recovery action.

Meetings

The Committee held 12 meetings during the financial year to carry out its tasks. The attendance by members is given on page 98 of the Annual Report. The proceedings of the Committee meetings have been regularly reported to the Board of Directors. Credit facilities, recommended by the Committee, were submitted to the monthly meeting of the Board for approval.



C R Jansz

Chairman – Credit Approval Committee

20 February 2017

Report of the Related Party Transactions Review Committee

The Composition

The Related Party Transactions Review Committee was established by the Board in December 2015 to be effective from 1 January 2016. The Related Party Transactions Review Committee appointed by the Board of Directors, presently consists of three Non-Executive Directors and the Chief Executive Officer. T Dharmarajah, an Independent Director is the Chairman of the Committee. C R Jansz, K P Cooray and A R Fernando are the other members.

The Company Secretary functions as the Secretary of the Committee.

The Mandate

The Committee adopted as its mandate, the tasks specified in Section 9 of the Colombo Stock Exchange (CSE) Listing Rules and the Terms of Reference, was formally approved by the Board during the year.

The primary purpose of the Committee is to evaluate and consider all transactions with related parties of the Bank, except the exempted transactions as set out in Rule 9.5 of the Listing Rules of the CSE, in order to ensure that transactions with related parties are on normal commercial terms, similar to those afforded to non-related parties. During the year, the Board formally adopted a Policy on Related Party Transactions.

The Procedure

The Committee meets as and when required and at least once in a calendar quarter and makes recommendations to the Board for consideration.

The Committee has put in place, the necessary processes to identify, review, disclose and monitor related party transactions according to the provisions contained in the Board approved Related Party Transactions Policy.

The Bank obtains on a quarterly basis a declaration from all Key Management Personnel on a structured format to assist in the process of collating related party transactions. Relevant officers are informed of the applicable regulatory requirement relating to related party transactions and have been advised to submit a report on the prescribed format for transactions that require a review by the Committee.

Meetings

The Committee held nine meetings during the financial year to carry out its task. The attendance by members is given on page 98 of the Annual Report. The proceedings of the Committee meetings have been regularly reported to the Board of Directors.



T Dharmarajah

Chairman – Related Party Transactions Review Committee

20 February 2017