

DIRECTORS' STATEMENT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Responsibility

In line with the Banking Act Direction No. 11 of 2007, Section 3 (8) (ii) (b), the Board of Directors present this Report on Internal Control over Financial Reporting.

The Board of Directors ('Board') is responsible for the adequacy and effectiveness of the internal control mechanism in place at National Development Bank PLC ('the Bank'). In considering such adequacy and effectiveness, the Board recognizes that the business of banking requires reward to be balanced with risk on a managed basis and as such the internal control systems are primarily designed with a view to highlighting any deviations from the limits and indicators which comprise the risk appetite of the Bank. In this light, the system of internal controls can only provide reasonable, but not absolute assurance, against material misstatement of financial information and records or against financial losses or fraud.

The Board has established an ongoing process for identifying, evaluating and managing the significant risks faced by the Bank and the Group and this process includes enhancing the system of internal controls over financial reporting as and when there are changes to business environment or regulatory guidelines. The process is regularly reviewed by the Board, in line with the Guidance for Directors of Banks on the Directors' Statement on Internal Control issued by The Institute of Chartered Accountants of Sri Lanka. The Board has assessed the internal control over financial reporting taking into account principles for the assessment of the internal control system as given in that guidance.

The Board is of the view, that the system of internal controls over financial reporting in place is sound and adequate to provide reasonable assurance regarding the reliability of financial reporting, and that the preparation of Financial Statements for external purposes is in accordance with relevant accounting principles and regulatory requirements.

The management assists the Board in the implementation of the Board's policies and procedures on risk and control by identifying and assessing the risks faced and in the design, operation and monitoring of suitable internal controls to mitigate and control these risks.

Key Features of the Process Adopted in Applying and Reviewing the Design and Effectiveness of the Internal Control System over Financial Reporting

The key processes that have been established in reviewing the adequacy and integrity of the system of internal controls with respect to financial reporting include the following:

- Various committees are established by the Board to assist the Board in ensuring the effectiveness of the Bank's daily operations and that the Bank's operations are in accordance with the corporate objectives, strategies and the annual budget as well as the policies and business directions that have been approved.
- Internal Audit department checks the compliance with policies and procedures and the effectiveness of internal controls during their audits. The Internal Audit department uses a top-down risk-based auditing approach enhancing the Risk-Based Auditing Process. The entire audit

universe is audited annually, at determined intensities based on the risk assessment covering the entire Group. The Audit Committee reviews the findings of the internal audits completed and their evaluation of the Bank's internal control systems. The Committee also reviews updates on audit activities and the scope and the adequacy of coverage of the approved audit plan and any improvements thereto, and has detailed discussions on any unsatisfactory audits, reviewing the action plans to address these areas and the implementation status.

- The Board Audit Committee of the Bank also reviews internal control issues identified by the External Auditor, regulatory authorities and the management and evaluates the adequacy and effectiveness of the risk management and internal control systems. The minutes of the Board Audit Committee meetings are forwarded to the Board of the Bank on a periodic basis. Further details of the activities undertaken by the Audit Committee of the Bank, are set out in the Audit Committee Report on pages 186 to 188.
- In assessing the internal control system over financial reporting, identified officers of the Bank collated all procedures and controls that are connected with significant accounts and disclosures of the Financial Statements of the Bank. These in turn were observed and checked by the Internal Audit department for suitability of design and effectiveness on an ongoing basis. The assessment did not include subsidiaries of the Bank. The comments/recommendations made by the External Auditors in connection with the internal control system over financial reporting

during the year, will be taken into consideration to further strengthen the internal control system over financial reporting process.

- Further to the adoption of new Sri Lanka Accounting Standards comprising SLFRS and LKAS, the Bank further strengthened the processes and procedures initially applied to adopt the aforementioned accounting standards during the years based on the feedback received from the External Auditors, Internal Audit department, Regulators and the Board Audit Committee. The Bank will continue to further strengthen processes such as impairment of loans and receivables, reconciliation process and Financial Statement Disclosures related to Risk Management based on the feedback received from Internal and External Auditors and as per Best Practices. The Bank has also recognized the need to introduce an automated financial reporting process in order to comply with the requirements of recognition, measurement, classification and disclosure of the financial instruments more effectively and efficiently. The management is currently reviewing options available to automate the financial reporting process.

Confirmation

Based on the above processes, the Board confirms that the financial reporting system of the Bank has been designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of Financial Statements for external purposes and has been done in accordance with Sri Lanka Accounting Standards and regulatory requirements of the Central Bank of Sri Lanka.

Review of the Statement by External Auditors

The External Auditors have reviewed the above Directors' Statement on internal control over financial reporting included in the Annual Report of the Bank for the year ended 31 December 2015 and reported to the Board that nothing has come to their attention that causes them to believe that the statement is inconsistent with their understanding of the process adopted by the Board in the review of the design and effectiveness of the internal control over financial reporting of the Bank.

By order of the Board,



N G Wickremeratne
Chairman



T L F Jayasekera
Chairman Audit Committee



R Theagarajah
Chief Executive Officer

12 February 2016
Colombo