

Report of the Audit Committee

Composition

The Board appointed Audit Committee comprises three Independent Non-Executive Directors. The Committee is chaired by Mr P M B Fernando who is a Fellow Member of The Institute of Chartered Accountants of Sri Lanka and possesses considerable experience in the field of finance and auditing.

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

Mr P M B Fernando – Chairman
Ms Hiroshini Fernando
Mr H A J De Silva Wijeyeratne

Mr T Dharmarajah, Independent Director, retired during the year and the Board appointed Mr H A J De Silva Wijeyeratne as an Independent Director representing the membership of the Audit Committee with effect from 1 July 2020

Brief profiles of the members are given on pages 13 to 16.

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 Terms of Reference of the Committee was last reviewed and approved by the Board in October 2020. 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.

Meetings

The Head of Group Internal Audit functioned as the Secretary to the Committee for the year ended 31 December 2020. During the year, 12 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 110 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 three meetings with the External Auditor; KPMG independently, without the presence of the Executive Management, to discuss the progress and conclusion of the audits.

Principal activities conducted during 2020

Review of financial reporting

The Committee reviewed the effectiveness of the Financial Reporting System in place, to ensure reliability of information provided to the stakeholders. The Committee reviewed

that to the best of its knowledge and belief, the Financial Statements issued for external purposes by DFCC Bank PLC (the 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 assisted 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. In carrying out the overseeing responsibilities, the Committee reviewed:

- 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.
- All critical accounting policies, practices, related changes thereto, alternative accounting treatments, major judgement 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 in conjunction with the Management, External, and Internal Auditors.
- The assessment of adequacy of provision for Expected Credit Loss (ECL) recognised in the financial statements based on the internal models, management overlay computed based on stress testing the exposures to risk elevated sectors,

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to address the potential implications of COVID-19 Pandemic and the moratorium schemes introduced to support the recovery of the economy.

- All quarterly unaudited interim Financial Statements and Financial Statements for the year ended 31 December 2020, together with supporting information that included significant assumptions and judgements made in the preparation of Financial Statements.
- 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 operations, future prospects, and sustainability indicators of the Bank and discussed with the Management regularly to ensure that all relevant matters have been taken into account in the preparation of the Financial Statements and that the 2020 Financial Statements are reliable and presents a true and fair view of the state of affairs of the Bank.

Review of internal control system

The Audit Committee assessed the effectiveness of internal controls over financial reporting as at 31 December 2020 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 perform 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 140 to 142.

Group 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 independent audit functions 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 subsidiaries, and to all the premises of the Bank and subsidiaries. The Committee had necessary interactions with the Head of Internal Audit throughout the year. The Audit Committee monitored and reviewed the scope, resources, extent, and effectiveness of the activities of the Bank's Internal Audit Department.

The Group Audit function is governed by the Group Audit Charter which defines the internal audit's purpose, authority, independence, reporting, responsibility and access in order to assist Group Audit to discharge its function independently. The Group Audit Charter and Audit Manual were revised and approved in September 2020 by the Board Audit Committee.

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 2020. 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 objective across the audited units/branches. Process Audits were conducted on specific business processes to review the adequacy, efficiency and effectiveness of the procedures, processes, related controls and further to ensure that the intended objectives and benefits are derived from the related processes of the Bank. The Potential Fraud Monitoring Unit under Internal Audit carry out testing and data analytics related to potential fraud risk areas on a continuous basis.

The start of the COVID-19 pandemic earlier during the year increased the level of attention of Internal Auditors to re-evaluate the internal audit activities and audit methodologies. A centralised monitoring function was commenced on selected high risk areas during the travel restricted period to assess the emerging risks and reassessment of internal control environment by internal audit as directed by the Board Audit Committee.

In 2020, the Board Audit Committee reviewed 198 audit reports of branches and departments, Information System Audits, Thematic Audits, Process Audits, and Special Investigations of the Bank. The Committee reviewed the Internal Audit Reports of the Bank's subsidiaries as well.

The Board Audit Committee advised Corporate Management to take precautionary measures on significant audit findings and obtained required assurances through affirmative confirmations from business units

on the remedial action in respect of the identified risks to maintain the effectiveness of the internal control system.

Independence of 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 as reviewed on Non-Audit Services provided by the External Auditors in September 2020.

The Committee ensured that the lead audit partner was rotated every five years in accordance with the Banking Act Direction No. 11 of 2007 on Corporate Governance for Licensed Commercial Banks in Sri Lanka. 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 the 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. Further, additional meetings were held with the External Auditors from time to time to discuss the Bank's interim audit findings and financial reporting improvements and changes required as a result of the COVID-19 pandemic situation.

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 the responses from the Management.

Reappointment of External Auditor

The Committee performed an evaluation of the Bank's External Auditor Messrs KPMG based on certain key areas and recommended to the Board of Directors that, KPMG Chartered Accountants, to be reappointed for the financial year ending 31 December 2021 subject to the approval of shareholders at the next Annual General Meeting.

Monitor the progress of implementation of new accounting pronouncements

The Committee reviewed the revised policy decisions relating to adoption of new and revised Sri Lanka Accounting Standards applicable to the Bank and made recommendations to the Board. Accordingly the Committee continuously monitored the progress of implementation of SLFRS 9 as per the requirements of Sri Lanka Accounting Standard – SLFRS 9 on "Financial Instruments" that has been issued with effective from 1 January 2018.

The Committee reviewed the Bank's Impairment Policy Manual on principles, methodologies, and assumptions during the year 2020 with consideration of elevated risks from the recent pandemic situation and also to be in line with the governing requirements. Further related changes were reviewed and approved by the Board Audit Committee and the Board.

The Committee continued to receive regular updates, detailed presentations from Management and results of independent reviews on same from the Bank's internal audit and External Auditor to ensure the compliance of SLFRS 9 on Financial Instruments. Special meetings were held to discuss many circulars issued by the regulator and accounting profession regarding

debt moratoriums and related accounting implications in assessing impairment provisions.

Good governance and whistle-blowing policy

The Committee continuously emphasised on sustaining ethical conduct amongst staff members. In this regard, the whistle-blowing Policy of the Bank and its subsidiaries was reviewed during the year 2020 and all members of staff were educated and encouraged to practice Whistle-blowing if they suspect any wrong doing while further strengthening the Policy as a communication channel to raise any genuine concerns. The Policy is subject to annual review in order to further improve its effectiveness.

All appropriate procedures and techniques are in place to conduct independent investigations into incidents reported through Whistle-blowing or identified through other channels. The whistle-blowing Policy guarantees the maintenance of strict confidentiality of the identity of the whistle-blowers.

Evaluation of the Committee

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

17 February 2021