

Independent Auditors' Report



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TO THE SHAREHOLDERS OF DFCC BANK PLC

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of DFCC Bank PLC ("the Bank") and the consolidated financial statements of the Bank and its subsidiaries ("the Group"), which comprise the statement of financial position as at 31 December 2020, and income statement, statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies as set out on pages 154 to 296 of this Annual Report.

In our opinion, the accompanying financial statements of the Bank and the Group give a true and fair view of the financial position of the Bank and the Group as at 31 December 2020, and of their financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

Basis for opinion

We conducted our audit in accordance with Sri Lanka Auditing Standards (SLAuSs). Our responsibilities under those standards are further described in the Auditors' Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Group in accordance with the Code of Ethics issued by CA Sri Lanka ("Code of Ethics") that are related to our audit of financial statements, and we have fulfilled our other ethical responsibilities in accordance with the Code of Ethics. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the Bank's financial statements and the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the Bank's financial statements and the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

KPMG, a Sri Lankan partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity.

M.R. Mihular FCA	P.Y.S. Perera FCA	C.P. Jayatilake FCA
T.J.S. Rajakarier FCA	W.W.J.C. Perera FCA	Ms. S. Joseph FCA
Ms. S.M.B. Jayasekara ACA	W.K.D.C. Abeyrathne FCA	S.T.D.L. Perera FCA
G.A.U. Karunaratne FCA	R.M.D.B. Rajapakse FCA	Ms. B.K.D.T.N. Rodrigo FCA
R.H. Rajan FCA	M.N.M. Shameel ACA	Ms. C.T.K.N. Perera ACA
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Principals - S.R.I. Perera FCMA(UK), LLB, Attorney-at-Law, H.S. Goonewardene ACA
Ms. P.M.K. Sumanasekara FCA

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Impairment of loans and receivables – “Financial Instruments”

Refer to Note 4 (Use of Judgements and Estimates), Note 17 (Impairment for loans and other losses), and Note 32 (Loans to and receivables from other customers), to these financial statements.

Risk description	Our responses
<p>As disclosed in Note 32 to these financial statements, the Bank has recorded loans to and receivables from other customers of LKR 317,233 Mn as at 31st December 2020. High degree of complexity and judgement is involved in estimating individual and collective impairment of LKR 15,323 Mn as at that date.</p> <p>Allowance for expected credit losses is a key audit matter due to the significance of the loans and receivables balance to the financial statements and the inherent complexity of the Bank's Expected Credit Loss (ECL) models used to measure ECL allowances. These models are reliant on data and a number of estimates including the impact of multiple economic scenarios and other assumptions such as defining a significant increase in credit risk (SICR).</p> <p>SLFRS 9 Financial Instruments requires the Bank to measure ECLs on a forward-looking basis reflecting a range of economic conditions. Post-model adjustments are made by the Bank to address known ECL model limitations or emerging trends in the loan portfolios. We exercise significant judgement in evaluating the economic scenarios used and the judgemental post model adjustments the Bank applies to the ECL results. The Bank's criteria selected to identify a SICR are key areas of judgement within the Bank's ECL methodology as these criteria determine if a forward-looking 12 months or lifetime allowance is recorded.</p>	<p>Our audit procedures to assess impairment of loans and advances to customers included the following:</p> <p>Testing key controls of the Bank in relation to:</p> <ul style="list-style-type: none"> → Reconciliation of the data used in the ECL calculation process to gross balances recorded within the general ledger as well as source systems; → IT system controls which record loans days past due, and non-performing loan classification. <p>Assessing impairment for individually significant customers</p> <ul style="list-style-type: none"> → We selected a sample (based on quantitative thresholds) of larger customers where impairment indicators have been identified by Management and assessed as higher risk or impaired, and a sample of other loans, focusing on larger exposures assessed by the Bank as showing signs of deterioration, or in areas of emerging risk (assessed against external market conditions and in particular considering the impacts of COVID-19). <p>We obtained Management's assessment of the recoverability of these exposures (including individual impairment calculations) and assessed whether individual impairment provisions, or lack of, were appropriate.</p> <p>This included the following procedures:</p> <ul style="list-style-type: none"> → Assessing the recoverability of the forecasted cash flows by comparing them to the historical performance of the customers and the expected future performance where applicable; → Assessing external collateral valuer's credentials and comparing external valuations to values used in management's impairment assessments → Exercising our judgement, our procedures included using our understanding of relevant industries and the macroeconomic environment and comparing with the data and assumptions used by the Bank in recoverability assessment. Where relevant we assessed the forecast timing of future cash flows in the context of underlying valuations and business plans and evaluated key assumptions used in the valuations → Testing the implementation of the Bank's Significant Increase in Credit Risk (SICR) methodology by re-performing the staging calculation for a sample of loan → For a sample of customers loans which were not identified as displaying indicators or impairment by Management, we reassessed the conclusions made by the Management by reviewing the historical performance of the customers and formed our own view whether any impairment indicators were present.

Risk description	Our responses
<p>The COVID-19 pandemic has meant that assumptions regarding the economic outlook are more uncertain which, combined with varying government responses, increases the level of judgement required by the Bank in calculating the ECL, and the associated audit risk. Additionally, allowances for individually significant loans exceeding specific thresholds are individually assessed by the Bank. We exercise significant judgement in challenging the assessment of specific allowances based on the expected future cash repayments and estimated proceeds from the value of the collateral held by the Bank in respect of the loans.</p> <p>The disclosures regarding the Bank's application of SLFRS 9 are key to explaining the key judgements and material inputs to the SLFRS 9 ECL results.</p>	<p>Assessing the adequacy of collectively assessed provisions</p> <p>We tested key controls of the Bank in relation to:</p> <ul style="list-style-type: none"> → The ECL model governance and validation processes which involved assessment of model performance; → The assessment and approval of the forward-looking macroeconomic assumptions and scenario weightings, trends in the credit risk concentration of specific portfolios and our understanding of economic conditions. As part of this work we assessed the reasonableness of the Bank's considerations of the economic uncertainty relating to COVID-19. <p>Our further audit procedures included;</p> <ul style="list-style-type: none"> → Assessing the ongoing effectiveness of the SICR criteria and independently calculated the loans' stage. In addition, we assessed the reasonableness of the Bank's treatment of COVID-19 payment relief customers (moratorium/ debt concessionary) from a SICR perspective. → Evaluating key assumptions in the components of the Bank's post-model adjustments to the ECL allowance balance. This included assessing the requirement for additional allowances considering the Bank's ECL model and data limitations identified by the Bank's ECL model validation processes, particularly in light of the extreme volatility in economic scenarios caused by the current COVID-19 pandemic and government responses; → Working with KPMG Financial Risk Management specialists, we assessed the reasonability of the adjustments made by the Bank to the forward looking macroeconomic factors and assumptions used in the ECL model. → Assessing the completeness of additional allowance overlays by checking the consistency of risks we identified in the loan portfolios against the Bank's assessment. → Assessing the appropriateness of the Bank's disclosures in the financial report using our understanding obtained from our testing and against the requirements of the Sri Lanka Accounting Standards.

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IT systems and controls over financial reporting

Risk description	Our responses
<p>The Bank utilises many complex, interdependent Information Technology (IT) systems to process and record a high volume of transactions. Controls over access and changes to IT systems are critical to the recording of financial information and the preparation of financial statements which provides a true and fair view of the Bank's financial position and performance.</p> <p>The IT systems and controls, as they impact the financial recording and reporting of transactions, is a key audit matter as our audit approach could significantly differ depending on the effective operation of the Bank's IT controls.</p>	<p>We work with our KPMG IT specialists to perform audit procedures to test the technology control environment for key IT applications (systems) used in processing significant transactions and recording balances in the general ledger. We also tested automated controls embedded within these systems which link the technology-enabled business processes.</p> <p>Our further audit procedures included:</p> <p>General IT controls design, observation, and operation</p> <ul style="list-style-type: none"> → Assessing the governance and higher-level controls in place across the IT Environment, including the approach to Group policy design, review and awareness, and IT Risk Management practices. → Testing the sample of key controls operating over the information technology in relation to financial accounting and reporting systems, including system access and system change management, programme development and computer operations → Data integrity of critical system reporting used by us in our audit to select samples and analyse data used by Management to generate financial statements. <p>Application controls</p> <ul style="list-style-type: none"> → On sample basis, re-performed selected automated computations and compared our results with those from the system and the general Ledger; <p>User access controls operation</p> <ul style="list-style-type: none"> → Assessing the Management's evaluation of access rights granted to applicants relevant to financial accounting and reporting systems and tested resolution of a sample of exceptions. → Assessing the operating effectiveness of controls over granting, removal and appropriateness of access rights.

Other information

Management is responsible for the other information. The other information comprises the information included in the annual report, but does not include the financial statements and our Auditor's Report thereon.

Our opinion on the financial statements does not cover the other information and we will not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information identified above when it becomes available and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of Management and those charged with governance for the financial statements

Management is responsible for the preparation of financial statements that give a true and fair view in accordance with Sri Lanka Accounting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, Management is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Bank's and the Group's financial reporting process.

Auditors' responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an Auditors' Report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with SLAuSs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with SLAuSs, we exercise professional judgement and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank and the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by Management.
- Conclude on the appropriateness of Management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our Auditors' Report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our Auditors' Report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

→ Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with ethical requirements in accordance with the Code of Ethics regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our Auditors' Report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Report on other legal and regulatory requirements

As required by Section 163 (2) of the Companies Act No. 07 of 2007, we have obtained all the information and explanations that were required for the audit and, as far as appears from our examination, proper accounting records have been kept by the Bank.

CA Sri Lanka membership number of the engagement partner responsible for signing this Independent Auditors' Report is FCA 2294.



Chartered Accountants

Colombo, Sri Lanka

17 February 2021