

Notes to the Financial Statements

1. Corporate information

1.1 General

SANASA Development Bank PLC is a licensed specialised bank established under the Banking Act No. 30 of 1988. It is a limited liability company, incorporated and domiciled in Sri Lanka. The registered office of the Bank is located at No. 12, Edmenton Road, Colombo 6. The Bank has a primary listing on the Colombo Stock Exchange.

1.2 Principal activities

SANASA Development Bank PLC provides a comprehensive range of financial services encompassing Development Banking, Corporate Banking, Personal Banking, Corporate and Trade Finance, Leasing and Other Associated Activities.

1.3 Parent entity and ultimate parent entity

The Bank does not have an identifiable parent of its own.

1.4 Date of authorisation of issue

The Financial Statements for the year ended 31 December 2018 were authorised for issue in accordance with a resolution of the Directors on 8 March 2019.

2. Accounting policies

2.1 Basis of preparation

The Financial Statements have been prepared on a historical cost basis, except for financial assets recognised through other comprehensive income and other financial assets and liabilities held for trading. The Financial Statements are presented in Sri Lankan Rupees (LKR) and all values are rounded to the nearest rupee, except when otherwise indicated.

2.1.1 Changes in accounting policies and disclosures

In these Financial Statements, the Bank has applied SLFRS 9 and SLFRS 15, effective for annual periods beginning on or after 1 January 2018, for the first time.

SLFRS 9 – Financial Instruments

SLFRS 9 replaces LKAS 39 for annual periods on or after 1 January 2018. The Bank has not restated comparative information for 2017 for financial instruments in the scope of SLFRS 9. Therefore, the comparative information for 2017 is reported under LKAS 39 and is not comparable to the information presented for 2018. Differences arising from the adoption of SLFRS 9 have been recognised directly in retained earnings as of 1 January 2018 and are disclosed in Note 43.

SLFRS 15 – Revenue from Contracts with Customers

Since 1 January 2018, the Bank has also adopted SLFRS 15. The adoption of SLFRS 15 did not impact the timing or amount of fee and commission income from contracts with customers and the related assets and liabilities recognised by the Bank.

Apart from the changes mentioned above, the accounting policies have been consistently applied by the Company with those of the previous financial year in accordance with the Sri Lanka Accounting Standard – LKAS 1 on “Presentation of Financial Statements”.

2.1.2 Statement of compliance

The Financial Statements of the Bank which comprise the statement of financial position, statement of comprehensive income, statement of changes in equity, statement of cash flow and significant accounting policies and notes have been prepared in accordance with Sri Lanka Accounting Standards (SLFRSs and LKASs) laid down by The Institute of Chartered Accountants of Sri Lanka and are in compliance with the requirements of the Companies Act No. 07 of 2007. The presentation of the Financial Statements is also in compliance with the requirements of the Banking Act No. 30 of 1988 and amendments thereto.

2.1.3 Presentation of financial statements

The Bank presents its statement of financial position broadly in order of liquidity. An analysis regarding recovery or settlement within 12 months after the statement of financial position date (current) and more than 12 months after the statement of financial position date (non-current) is presented in Note 40.

Financial assets and financial liabilities are offset and the net amount reported in the statement of financial position only when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the assets and settle the liability simultaneously. Income and expense is not offset in the income statement unless required or permitted by any accounting standard or interpretation, and as specifically disclosed in the accounting policies of the Bank.

2.2 Significant accounting judgements, estimates and assumptions

In the process of applying the Bank’s accounting policies, management has exercised judgement and estimates in determining the amounts recognised in the Financial Statements. The most significant uses of judgement and estimates are as follows:

(a) Going concern

The Bank’s Management has made an assessment of the Bank’s ability to continue as a going concern and is satisfied that the Bank has the resources to continue in business for the foreseeable future. Furthermore, Management is not aware of any material uncertainties that may cast significant doubt upon the Bank’s ability to continue as a going concern. Therefore, the Financial Statements continue to be prepared on the going concern basis.

(b) Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recorded on the statement of financial position cannot be derived from active markets, they are determined using judgement is required to establish

fair values. The judgements include considerations of liquidity and model inputs such as volatility for longer dated derivatives and discount rates, prepayment rates and default rate assumptions for asset backed securities. The valuation of financial instruments is described in more detail in Note 38.

(c) Impairment losses on loans and advances

The Bank reviews its individually significant loans and advances at each statement of financial position date to assess whether an impairment loss should be recorded in the income statement. In particular, Management judgement is required in the estimation of the amount and timing of future cash flows when determining the impairment loss. These estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the allowance.

Loans and advances that have been assessed individually and found to be impaired have been provide for the impairment loss on loans and advances as disclosed in Note 7 and Note 16. All individually not insignificant loans and advances and unimpaired individual significant customers are then assessed collectively, in groups of assets with similar risk characteristics, to determine whether provision should be made due to Expected Credit Loss (ECL – applicable from 1 January 2018 onwards) events for which there is objective evidence but whose effects are not yet evident. The collective assessment takes account of data from the loan portfolio (such as levels of arrears, remaining maturity, customer identification number, etc.), and judgements to the effect of concentrations of risks and economic data (including levels of unemployment, gross domestic production, interest rate and exchange rate fluctuation).

(d) Deferred tax assets

Deferred tax assets are recognised in respect of tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilised. Judgement is required to determine the amount of deferred tax assets that can be recognised, based upon the likely timing and level of future taxable profits, together with future tax planning strategies.

(e) Taxation

The Bank is subject to income taxes and other taxes including VAT on financial services. Significant judgement was required to determine the total provision for current, deferred and other taxes pending the issue of tax guideline on the treatment of the adoption of SLFRSs in the Financial Statements and the taxable profit for the purpose of imposition of taxes. Uncertainties exist, with respect to the interpretation of the applicability of tax laws, at the time of the preparation of these Financial Statements.

The Bank recognised assets and liabilities for current deferred and other taxes based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the income.

(f) Defined benefit plan

The cost of the defined benefit plan is determined using an actuarial valuation. The actuarial valuation involves making assumptions about discount rates, salary increment rate, age of retirement, and mortality rates. Due to the long-term nature of these plans, such estimates are subject to significant uncertainty. The assumptions used for valuation is disclosed in more detail in Note 28.1.4.

(g) Useful lifetime of the property and equipment

The Bank reviews the residual values, useful lives and methods of depreciation of assets as at each reporting date. Judgement of the Management is exercised in the estimation of these values, rates, methods' and hence they are subject to uncertainty.

2.3 Summary of significant accounting policies

2.3.1 Foreign currency translation

The Financial Statements are presented in Sri Lankan Rupees (LKR).

Transactions and balances

Transactions in foreign currencies are initially recorded at the functional currency rate of exchange ruling at the date of the transaction.

Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange at the statement of financial position date. All differences arising on non-trading activities are taken to "Other operating income" in the income statement.

2.3.2 Financial Instruments

2.3.2.1 Initial recognition and subsequent measurement

(a) Date of recognition

All financial assets and liabilities are initially recognised on the trade date, i.e., the date that the Bank becomes a party to the contractual provisions of the instrument. This includes "regular way trades": purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place.

(b) Initial measurement of financial instruments

The classification of financial instruments at initial recognition depends on the purpose and the Management's intention for which the financial instruments were acquired and their characteristics. All financial instruments are measured initially at their fair value plus transaction costs, except in the case of financial assets and financial liabilities recorded at fair value through profit or loss.

(c) Subsequent measurement

(a) Financial Instruments (Policies applicable after 1 January 2018)

(i) Classification of financial instruments

The Bank classifies its financial assets into the following measurement categories:

- Measured at fair value (either through other comprehensive income, or through Profit or Loss); and
- Measured at amortised cost.

The classification depends on the Bank's business model for managing financial assets and the contractual terms of the financial assets cash flows. The Bank classifies its Financial Liabilities at amortised cost unless it has designated liabilities at fair value through profit.

(ii) Financial assets measured at amortised cost

Placements, loans and receivables to other customers and debt and other instruments are measured at amortised cost where they have:

- Contractual terms that give rise to cash flows on specified dates, that represent solely payments of principal and profits on the principal amount outstanding; and
- Are held within a business model whose objective is achieved by holding to collect contractual cash flows.

These instruments are initially recognised at fair value plus directly attributable transaction costs and subsequently measured at amortised cost. The measurement of credit impairment is based on the three-stage expected credit loss model described below in Note (vi) Impairment of Financial Assets.

(iii) Financial assets measured at fair value through other comprehensive income

Equity instruments

Investment in equity instruments that are neither trading financial assets recognised through profit or loss, nor contingent consideration recognised by the Bank in a business combination to which SLFRS 3 – “Business Combinations” applies, are measured at fair value through other comprehensive income, where an irrevocable election has been made by Management. Long-term nature of investment for portfolios where Management does not consider an irrevocable election of adopting fair value through other comprehensive income, by default such investments shall be measured at fair value through profit and loss.

Amounts presented in other comprehensive income are not subsequently transferred to profit or loss. Dividends on such investments are recognised in profit or loss.

(iv) Fair value through profit or loss

Fair value through profit or loss comprise:

- Financial investments – for trading;
- Instruments with contractual terms that do not represent solely payments of principal and profit.

Financial instruments held at fair value through profit or loss are initially recognised at fair value, with transaction costs recognised in the statement of profit or loss as incurred. Subsequently, they are measured at fair value and any gains or losses are recognised in the statement of profit or loss as they arise.

Where a financial asset is measured at fair value, a credit valuation adjustment is included to reflect the creditworthiness of the counterparty, representing the movement in fair value attributable to changes in credit risk.

(a) Financial investments – for trading

A financial investment is classified as financial assets recognised through profit or loss if it is acquired or incurred principally for the purpose of selling or repurchasing in the near term, or forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking, or it is a derivative not in a qualifying hedge relationship.

Government Securities and investment in Unit Trust Securities are classified as financial assets recognised through profit or loss and recognised at fair value. Refer Note 15.

(b) Financial instruments designated as measured at fair value through profit or loss

Upon initial recognition, financial instruments may be designated as measured at fair value through profit or loss. A financial asset may only be designated at fair value through profit or loss if doing so eliminates or significantly reduces measurement or recognition inconsistencies (i.e. eliminates an accounting mismatch) that would otherwise arise from measuring Financial Assets or Liabilities on a different basis. The Bank does not designate any financial instruments under this category.

(v) Impairment of financial assets

The Bank applies a three-stage approach to measuring Expected Credit Losses (ECLs) for the following categories of financial assets that are not measured at fair value through profit or loss:

Debt instruments

- Instruments measured at amortised cost and fair value through other comprehensive income;
- Loans and receivables to other customers; and
- Financial Guarantee Contracts

ECL is not recognised on equity instruments.

Financial assets migrate through the following three stages based on the change in credit risk since initial recognition:

Stage 1: 12 months ECL

For exposures where there has not been a significant increase in credit risk since initial recognition and that are not credit impaired upon origination, the portion of the lifetime ECL associated with the probability of default events occurring within the next 12 months is recognised.

Bank determines 12-month ECL from customers who are not significantly credit deteriorated (i.e. less than 30 days past due):

Stage 2: Lifetime ECL – not credit impaired

For exposures where there has been a significant increase in credit risk since initial recognition but are not credit impaired, a lifetime ECL (i.e. reflecting the remaining lifetime of the financial asset) is recognised.

In being consistent with the policies of the Bank, significant deterioration is measured through the rebuttable presumption of 30 days past due in line with the requirements of the standard.

Stage 3: Lifetime ECL – credit impaired

Exposures are assessed as credit impaired when one or more events that have a detrimental impact on the estimated future cash flows of that asset have occurred. For exposures that have become credit impaired, a lifetime ECL is recognised and financing income is calculated by applying the effective rate to the amortised cost (net of provision) rather than the gross carrying amount.

Determining the stage for impairment

At each reporting date, the Bank assesses whether there has been a significant increase in credit risk for exposures since initial recognition by comparing the risk of default occurring over the expected life between the reporting date and the date of initial recognition. The Bank considers reasonable and supportable information that is relevant and available without undue cost or effort for this purpose. This includes quantitative and qualitative information and also, forward-looking analysis.

An exposure will migrate through the ECL stages as asset quality deteriorates. If, in a subsequent period, asset quality improves and also reverses any previously assessed significant increase in credit risk since origination, then the provision for impairment loss reverts from lifetime ECL to 12-months ECL. Exposures that have not deteriorated significantly since origination, or where the deterioration remains within the Bank's investment grade criteria, or which are less than 30 days past due, are considered to have a low credit risk. The provision for impairment loss for these financial assets is based on a 12-month ECL. When an asset is uncollectible, it is written off against the related provision. Such assets are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off reduce the amount of the expense in the statement of profit or loss.

The Bank assesses whether the credit risk on an exposure has increased significantly on an individual or collective basis. For the purposes of a collective evaluation of impairment, financial instruments are grouped on the basis of shared credit risk characteristics, taking into account instrument type, credit risk ratings, date of initial recognition, remaining term to maturity, industry, geographical location of the borrower and other relevant factors.

Measurement of ECLs

ECLs are derived from unbiased and probability-weighted estimates of expected loss, and are measured as follows:

- Financial assets that are not credit-impaired at the reporting date: as the present value of all cash shortfalls over the expected life of the financial asset discounted by the effective rate. The cash shortfall is the difference between the cash flows due to the Bank in accordance with the contract and the cash flows that the Bank expects to receive.
- Financial assets that are credit-impaired at the reporting date: as the difference between the gross carrying amount and the present value of estimated future cash flows discounted by the effective rate.
- Undrawn commitments: as the present value of the difference between the contractual cash flows that are due to the Bank if the commitment is drawn down and the cash flows that the Bank expects to receive.
- Financial guarantee contracts: as the expected payments to reimburse the holder less any amounts that the Bank expects to recover.

For further details on how the Bank calculates ECLs including the use of forward-looking information, refer to the credit quality of financial assets section in Note 23. For details on the effect of modifications of loans and receivables to other customers on the measurement of ECL refer to note on provision for expected credit loss.

ECLs are recognised using a provision for impairment loss account in statement of profit and loss. The Bank recognises the provision charge in statement of profit or loss, with the corresponding amount recognised in other comprehensive income, with no reduction in the carrying amount of the asset in the statement of financial position.

The mechanics of the ECL calculations are outlined below and the key elements are, as follows:

PD: The probability of default is an estimate of the likelihood of default over a given time horizon. A default may only happen at a certain time over the assessed period, if the facility has not been previously derecognised and is still in the portfolio.

EAD: The exposure at default is an estimate of the exposure at a future default date, taking into account expected changes in the exposure after the reporting date, including repayments of capital and financing income, whether scheduled by contract or otherwise, expected draw downs on committed facilities, and accrued financing income from missed payments.

LGD: The loss given default is an estimate of the loss arising in the case where a default occurs at a given time. It is based on the difference between the contractual cash flows due and those that the Bank would expect to receive, including the realisation of any collateral.

(vi) Recognition and derecognition of financial instruments

A financial asset or financial liability is recognised in the Statement of Financial Position when the Bank becomes a party to the contractual provisions of the instrument, which is generally on trade date. Loans and Receivables to other customers are recognised when cash is advanced (or settled) to the borrowers.

Financial assets at fair value through profit or loss are recognised initially at fair value. All other financial assets are recognised initially at fair value plus directly attributable transaction costs.

The Bank derecognises a financial asset when the contractual cash flows from the asset expire or it transfers its rights to receive contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership are transferred. Any interest in transferred financial assets that is created or retained by the Bank is recognised as a separate asset or liability.

A financial liability is derecognised from the Statement of Financial Position when the Bank has discharged its obligation or the contract is cancelled or expires.

(vii) Offsetting

Financial assets and liabilities are offset and the net amount is presented in the balance sheet when the Bank has a legal right to offset the amounts and intends to settle on a net basis or to realise the asset and settle the liability simultaneously. Refer to note on financial risk management – Offsetting of Financial Assets and Liabilities.

(c) Critical accounting assumptions and estimates applicable for financial assets

The application of the Bank's accounting policies requires the use of judgements, estimates, and assumptions. If different assumptions or estimates were applied, the resulting values would change, impacting the net assets and income of the Bank.

Assumptions made at each reporting date are based on best estimates at that date. Although the Bank has internal control systems in place to ensure that estimates are reliably measured, actual amounts may differ from those estimates. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

The accounting policies which are most sensitive to the use of judgement, estimates, and assumptions are specified below:

(i) Fair value measurement

A significant portion of financial instruments are carried on the statement of financial position at fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Where the classification of a financial asset or liability results in it being measured at fair value, wherever possible, the fair value is determined by reference to the quoted bid or offer price in the most advantageous active market to which the Bank has immediate access. An adjustment for credit risk is also incorporated into the fair value as appropriate.

Fair value for a net open position that is a financial liability quoted in an active market is the current offer price, and for a financial asset the bid price, multiplied by the number of units of the instrument held or issued.

Where no active market exists for a particular asset or liability, the Bank uses a valuation technique to arrive at the fair value, including the use of transaction prices obtained in recent arm's length transactions, discounted cash flow analysis, option pricing models and other valuation techniques, based on market conditions and risks existing at reporting date. In doing so, fair value is estimated using a valuation technique that makes maximum use of observable market inputs and places minimal reliance upon entity-specific inputs.

The best evidence of the fair value of a financial instrument at initial recognition is the transaction price (i.e. the fair value of the consideration given or received) unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (i.e. without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets. When such evidence exists, the Bank recognises the difference between the transaction price and the fair value in profit or loss on initial recognition (i.e. on day one).

(ii) Impairment charges on loans and receivables to other customers

Judgement is required by Management in the estimation of the amount and timing of future cash flows when determining an impairment loss for loans and receivables to other customers. In estimating these cash flows, the Bank makes judgements about the customer's financial situation and the net realisable value of collateral. These estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the impairment allowance.

A collective assessment of impairment takes into account data from the advance portfolio (such as credit quality, levels of arrears, credit utilisation, advances to collateral ratios etc.), and concentrations of risk and economic data (including levels of unemployment, inflation, GDP Growth Rate, country risk and the performance of different individual groups). The impairment loss on financing and receivables is disclosed in more detail in Note 23 – Provision for Expected Credit Losses.

(d) Subsequent measurement (Policies applicable before 1 January 2018)

The subsequent measurement of financial assets depends on their classification as described below:

(a) Financial assets held for trading

Financial assets or financial liabilities held for trading are recorded in the statement of financial position at fair value. Changes in fair value are recognised in “Net operating income”. Interest and dividend income or expense is recorded in “Net trading income” according to the terms of the contract, or when the right to the payment has been established. Included in this classification are debt securities, listed equities and Unit trusts.

(b) Financial assets and financial liabilities designated at fair value through profit or loss

Financial assets and financial liabilities classified in this category are those that have been designated by Management on initial recognition. Management may only designate an instrument at fair value through profit or loss upon initial recognition when the following criteria are met, and designation is determined on an instrument by instrument basis:

The designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets or liabilities or recognising gains or losses on them on a different basis.

The assets and liabilities are part of a financial assets, financial liabilities or both which are managed and their performance evaluated on a fair value basis, in accordance with a documented risk management or investment strategy.

Financial assets and financial liabilities at fair value through profit or loss are recorded in the statement of financial position at fair value. Changes in fair value are recorded in “Net gain or loss on financial assets and liabilities designated at fair value through profit or loss”. Interest is earned or incurred is accrued in “Interest income” or “Interest expense”, respectively, using the effective interest rate (EIR), while dividend income is recorded in “Other operating income” when the right to the payment has been established.

The Bank has not designated any financial assets and liabilities upon initial recognition as at fair value through profit or loss.

(c) “Day 1” profit or loss

When the transaction price differs from the fair value of other observable current market transactions in the same instrument or based on a valuation technique whose variables include only data from observable markets, the Bank immediately recognises the difference between the transaction price and fair value (“Day 1” profit or loss) in “Net operating income”. In cases where fair value is determined using data which is not observable, the difference between the transaction price and model value is only recognised in the income statement when the inputs become observable, or when the instrument is derecognised.

(d) Held-to-maturity financial investments

Held-to-maturity financial investments are non-derivative financial assets with fixed or determinable payments and fixed maturities, which the Bank has the intention and ability to hold to maturity. After initial measurement, held-to-maturity financial investments are subsequently measured at amortised cost using the EIR, less impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the EIR. The amortisation is included in “Interest and similar income” in the income statement. The losses arising from impairment of such investments are recognised in the income statement line “Impairment for loans and other losses”. If the Bank were to sell or reclassify more than an insignificant amount of held-to-maturity investments before maturity (other than in certain specific circumstances), the entire category would be tainted and would have to be reclassified as available for sale. Furthermore, the Bank would be prohibited from classifying any financial asset as held to maturity during the following two years.

Included in this classification are debt securities and investment in debentures.

(e) Due from banks, loans and advances to customers (Loans and receivables)

“Due from banks” and “Loans and advances to customers” include non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than:

- Those that the Bank intends to sell immediately or in the near term and those that the Bank upon initial recognition designates as at fair value through profit or loss.
- Those that the Bank, upon initial recognition, designates as available for sale.
- Those for which the Bank may not recover substantially all of its initial investment, other than because of credit deterioration.

After initial measurement, amounts “Due from banks” and “Loans and advances to customers” are subsequently measured at amortised cost using the EIR, less allowance for impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees and costs that are an integral part of the EIR. The amortisation is included in “Interest income” in the comprehensive income. The losses arising from impairment are recognised in the comprehensive income in “Impairment for loans and receivables”.

Included in this classification are placement with local banks, other financial asset classified under loans and receivable and loans and receivable to customers.

(f) Available-for-sale financial investments

Available-for-sale investments include equity and debt securities. Equity investments classified as available for sale are those which are neither classified as held-for-trading nor designated at fair value through profit or loss. The Bank has not designated any loans or receivables as available for sale. After initial measurement, available-for-sale financial investments are subsequently measured at fair value.

Unrealised gains and losses are recognised directly in equity in the “Available-for-sale reserve”. When the investment is disposed of, the cumulative gain or loss previously recognised in equity is recognised in the income statement in “Other operating income”. Where the Bank holds more than one investment in the same security they are deemed to be disposed of on a first-in first-out basis. Dividends earned whilst holding available-for-sale financial investments are recognised in the income statement as “Other operating income” when the right of the payment has been established. The losses arising from impairment of such investments are recognised in the income statement in “Impairment losses on financial investments” and removed from the “Available-for-sale reserve”.

Included in this classification is unquoted equity securities.

The initial and subsequent measurement of financial liabilities depends on their classification as described below:

At the inception the Bank determines the classification of its financial liabilities. Accordingly, financial liabilities are classified as:

- (i) Financial liabilities at Fair Value through Profit or Loss (FVTPL)
 - Financial liabilities held for trading
 - Financial liabilities designated at fair value through profit or loss
- (ii) Financial liabilities at amortised cost

The subsequent measurement of financial liabilities depends on their classification.

(i) Financial liabilities at Fair Value through Profit or Loss (FVTPL)

Financial liabilities at FVTPL include financial liabilities held for trading and financial liabilities designated upon initial recognition at fair value through profit or loss. Subsequent to initial recognition, financial liabilities at FVTPL are fair value, and changes therein recognised in profit or loss.

Financial liabilities are classified as held for trading if they are acquired principally for the purpose of selling or repurchasing in the near term or holds as a part of the portfolio that is managed together for short-term profit or position taking. This category includes derivative financial instruments entered into by the Bank which are not designated as hedging instruments in the hedge relationships as defined by the Sri Lanka Accounting Standards – LKAS 39 on “Financial Instruments: Recognition and Measurements”. Separated embedded derivatives are also classified as held for trading unless they are designated as effective hedging instruments. Gains or losses on liabilities held for trading are recognised in the income statement.

The Bank does not have any financial liabilities under this category.

(ii) Financial liabilities at amortised cost

Financial instruments issued by the Bank that are not designated at fair value through profit or loss, are classified as liabilities at amortised cost under “due to customers and other borrowings” as appropriate, where the substance of the contractual arrangement results in the Bank having an obligation either to deliver cash or another financial asset to the holder, or to satisfy the obligation other than by the exchange of a fixed amount of cash or another financial assets for a fixed number of own equity shares at amortised cost using EIR method.

After initial recognition, such financial liabilities are substantially measured at amortised cost using the EIR method. Amortised cost is calculated by taking into account any discount or premium on the issue and costs that are integral parts of the EIR. The EIR amortisation is included in “Interest expenses” in the Income Statement. Gains and losses are recognised in the income statement when the liabilities are derecognised as well as through the EIR amortisation process.

This category consists of due to other customers, other borrowings, debt securities issued, and subordinated term debts.

2.3.2.2 Determination of fair value

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

- In the principal market for the asset or liability, or
- In the absence of a principal market, in the most advantageous market for the asset or liability

The principal or the most advantageous market must be accessible by the Bank.

The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The Bank uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

All assets and liabilities for which fair value is measured or disclosed in the Financial Statements are categorised within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

Level 1 – Quoted (unadjusted) market prices in active markets for identical assets or liabilities

Level 2 – Valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable

Level 3 – Valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable –

For assets and liabilities that are recognised in the Financial Statements on a recurring basis, the Bank determines whether transfers have occurred between levels in the hierarchy by reassessing categorisation (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

The disclosure of fair value of financial instruments is disclosed in Note 38.

2.3.2.3 Impairment of financial assets

The Bank assesses at each statement of financial position date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred "loss event") and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, the probability that they will enter bankruptcy or other financial reorganisation, default or delinquency in interest or principal payments and where observable data indicates that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

(a) Financial assets carried at amortised cost

For financial assets carried at amortised cost (such as placement with banks, loans and advances to customers as well as held-to-maturity investments), the Bank first assesses individually whether objective evidence of impairment exists for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the assets' carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement. Interest income continues to be accrued on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. The interest income is recorded as part of "Interest and similar income". Loans together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realised or has been transferred to the Bank. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced by adjusting the allowance account. If a future write-off is later recovered, the recovery is credited to the "Income Statement".

The present value of the estimated future cash flows is discounted at the financial asset's original EIR. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current EIR. If the Bank has reclassified trading assets to loans and advances, the discount rate for measuring any impairment loss is the new EIR determined at the reclassification date. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of the Bank's credit risk characteristics such as asset type, industry, geographical location, past-due status and other relevant factors.

Future cash flows on a group of financial assets that are collectively evaluated for impairment are estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. Estimates of changes in future cash flows reflect, and are directionally consistent with, changes in related observable data from year to year (such as changes in unemployment rates, property prices, commodity prices, payment status, or other factors that are indicative of incurred losses in the group and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

See Note 7 for details of impairment losses on financial assets carried at amortised cost, Note 16 for an analysis of the impairment allowance on loans and advances.

(b) Available-for-sale financial investments

For available-for-sale financial investments, the Bank assesses at each reporting date whether there is objective evidence that an investment is impaired.

In the case of debt instruments classified as available for sale, the Bank assesses individually whether there is objective evidence of impairment based on the same criteria as financial assets carried at amortised cost.

However, the amount recorded for impairment is the cumulative loss measured as the difference between the amortised cost and the current fair value, less any impairment loss on that investment previously recognised in the income statement. Future profit income is based on the reduced carrying amount and is accrued using the rate of return used to discount the future cash flows for the purpose of measuring the impairment loss.

In the case of equity investments classified as available for sale, objective evidence would also include a “significant” or “prolonged” decline in the fair value of the investment below its cost. Where there is evidence of impairment, the cumulative loss measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that investment previously recognised in the income statement – is removed from equity and recognised in the income statement. Impairment losses on equity investments are not reversed through the income statement; increases in the fair value after impairment are recognised in other comprehensive income.

(c) Renegotiated loans

Where possible, the Bank seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated any impairment is measured using the original EIR as calculated before the modification of terms and the loan

is no longer considered past due. Management continually reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan’s original EIR.

(d) Collateral valuation

The Bank seeks to use collateral, where possible, to mitigate its risks on financial assets. The collateral comes in various forms such as cash, securities, letters of credit/guarantees, real estate, receivables, inventories, other non-financial assets and credit enhancements such as netting agreements. The fair value of collateral is generally assessed, at a minimum, at inception and based on the guidelines issued by the Central Bank of Sri Lanka. Non-financial collateral, such as real estate, is valued based on data provided by third parties such as independent values and Audited Financial Statements.

(e) Collateral repossessed

The Bank’s policy is to determine whether a repossessed asset is best used for its internal operations or should be sold. Assets determined to be useful for the internal operations are transferred to their relevant asset category at the lower of their repossessed value or the carrying value of the original secured asset.

2.3.2.4 Derecognition of financial assets and financial liabilities

(A) Financial assets

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognised when:

- The rights to receive cash flows from the asset have expired.
- The Bank has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a “pass-through” arrangement; and either:
 - the Bank has transferred substantially all the risks and rewards of the asset, or
 - The Bank has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

When the Bank has transferred its rights to receive cash flows from an asset or has entered into a pass-through arrangement, and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Bank’s continuing involvement in the asset. In that case, the Bank also recognises an associated liability. The transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the Bank has retained. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Bank could be required to repay.

(B) Financial liabilities

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires. Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability. The difference between the carrying value of the original financial liability and the consideration paid is recognised in profit or loss.

2.3.2.5 Offsetting financial instruments

Financial assets and financial liabilities are offset and the net amount reported in the statement of financial position if, and only if, there is a currently enforceable legal right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously. This is not generally the case with master netting agreements, therefore, the related assets and liabilities are presented gross in statement of financial position.

2.3.3 Repurchase and reverse repurchase agreements

Securities sold under agreements to repurchase at a specified future date are not derecognised from the statement of financial position as the Bank retains substantially all the risks and rewards of ownership. The corresponding cash received is recognised in the statement of financial position as an asset with a corresponding obligation to return it, including accrued interest as a liability within "repurchase agreements", reflecting the transaction's economic substance as a loan to the Bank. The difference between the sale and repurchase prices is treated as interest expense and is accrued over the life of agreement using the EIR. When the counterparty has the right to sell or replace the securities, the Bank reclassifies those securities in its statement of financial position to "Financial assets held-for-trading pledged as collateral" or to "Financial investments available-for-sale pledged as collateral", as appropriate. Conversely, securities purchased under agreements to resell at a specified future date are not recognised in the statement of financial position. The consideration paid, including accrued interest, is recorded in the statement of financial position, within "reverse repurchase agreements", reflecting the transaction's economic substance as a loan by the Bank.

The difference between the purchase and resale prices is recorded in "Net interest income" and is accrued over the life of the agreement using the EIR. If securities purchased under agreement to resell are subsequently sold to third parties, the obligation to return the securities is recorded as a short sale within "Financial liabilities held-for-trading" and measured at fair value with any gains or losses included in "Net operating income".

2.3.4 Securities lending and borrowing

Securities lending and borrowing transactions are usually collateralised by securities or cash. The transfer of the securities to counterparties is only reflected on the statement of financial position if the risks and rewards of ownership are also transferred. Cash advanced or received

as collateral is recorded as an asset or liability. Securities borrowed are not recognised on the statement of financial position, unless they are then sold to third parties, in which case the obligation to return the securities is recorded as a trading liability and measured at fair value with any gains or losses included in "Net operating income".

2.3.5 Leases

The determination of whether an arrangement is a lease or it contains a lease, is based on the substance of the arrangement and requires an assessment of whether the fulfilment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset.

2.3.5.1 Operating Leases**Bank as a lessor**

Leases where the Bank does not transfer substantially all the risk and benefits of ownership of the asset are classified as operating leases. Initial direct costs incurred in negotiating operating leases are added to the carrying amount of the leased asset and recognised over the lease term on the same basis as rental income. Contingent rents are recognised as revenue in the period in which they are earned.

2.3.5.2 Finance leases**Bank as a lessor**

Assets leased to customers which transfer substantially all the risks and rewards associated with ownership other than legal title, are classified as "Finance leases". Amounts receivable under finance leases are included under "Loans and receivables to customers" in the statement of financial position after deduction of initial rentals received, unearned lease income and the accumulated impairment losses. When assets are held subject to a finance lease, the present value of the lease payments, discounted at the rate of interest implicit in the lease, is recognised as a receivable. The difference between the total payments receivable under the lease and the present value of the receivable is recognised as unearned finance income, which is allocated to accounting periods reflect a constant periodic rate of return.

2.3.6 Cash and cash equivalents

Cash and cash equivalents as referred to in the cash flow statement comprises cash on hand and balances with banks on demand or with an original maturity of three months or less.

2.3.7 Property and equipment

Property, plant and equipment are tangible items that are held for servicing, or for administrative purposes, and are expected to be used during more than one year.

Property and equipment are recognised if it is probable that future economic benefits associated with the asset will flow to the entity and the cost of the asset can be measured reliably in accordance with LKAS 16 on "Property, Plant and Equipment". Initially property and equipment are measured at cost.

(i) Basis of recognition and measurement

Cost model

An item of property, plant and equipment that qualifies for recognition as an asset is initially measured at its costs. Costs include expenditure that is directly attributable to the acquisition of the asset and cost is incurred subsequently to add to or replace a part of it. The cost of self-constructed assets includes the cost of materials and direct labour, any other costs directly attributable to bringing the asset to working condition for its intended use and the costs of dismantling and removing the items and restoring at the site on which they are located and capitalised borrowing costs. Purchase of software that is integral to the functionality of the related equipment is capitalised as a part of computer equipment.

When parts of property, plant and equipment have different useful lives, they are accounted for as separate items (major components) of property, plant and equipment.

The Bank applies the cost model to property, plant and equipment and records at cost of purchase or construction together with any incidental expenses thereon less accumulated depreciation and any accumulated impairment losses.

Changes in the expected useful life are accounted for by changing the amortisation period or method, as appropriate, and treated as changes in accounting estimates.

(ii) Subsequent cost

These are costs that are recognised in the carrying amount of an item, if it is probable that the future economic benefits embodied within that part will flow to the Bank and it can be reliably measured.

(iii) Repairs and maintenance

Repairs and maintenance are charged to the profit or loss during the financial period in which they are incurred. The cost of major renovations is included in the carrying amount of the assets when it is probable that future economic benefits in excess of the most recently assessed standard of performance of the existing assets will flow to the Bank and the renovation replaces an identifiable part of the asset. Major renovations are depreciated during the remaining useful life of the related asset.

(iv) Capital Work in progress

Capital work in progress is stated at cost. It would be transferred to the relevant asset when it is available for use, i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by Management. Capital work in progress is stated at cost less any accumulated impairment losses.

(v) Borrowing costs

As per LKAS 23 on "Borrowing Costs", the Bank capitalises the borrowing costs that are directly attributable to acquisition, construction or production of qualifying assets as part of the cost of the asset. A qualifying asset is an asset which takes a substantial period of time to get ready for its intended use or sale. Other borrowing costs are recognised in the profit or loss in the period in which they occur.

(vi) Derecognition

Property and equipment is derecognised on disposal or when no future economic benefits are expected from its use. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is recognised in "Other operating income" in the income statement in the year the asset is derecognised.

(vii) Depreciation

Depreciation is calculated using the straight-line method to write down the cost of property and equipment to their residual values over their estimated useful lives. Land is not depreciated. The estimated useful lives are as follows:

| | |
|-------------------------|----------|
| Buildings | 20 years |
| Computer hardware | 3 years |
| Machinery and equipment | 5 years |
| Motor vehicles | 4 years |
| Furniture and fittings | 5 years |

2.3.8 Investment properties

Properties held to earn rental income have been classified as investment properties. Investment properties initially recognised at cost. After initial recognition the Bank uses the cost method to measure all of its investment property in according with requirements in LKAS 16 on "Property, Plant and Equipment".

Investment properties are derecognised when either they have been disposed of or when the investment property is permanently withdrawn from use and no future economic benefit is expected from its disposal. Any gains or losses on the retirement or disposal of an investment property are recognised in the income statement in the year of retirement or disposal.

Transfers are made to investment property when, and only when, there is a change in use, evidenced by the end of owner occupation, commencement of an operating lease to another party or completion of construction or development. Transfers are made from investment property when, and only when, there is a change in use, evidenced by commencement of owner occupation or commencement of development with a view to sale.

Depreciation is calculated using the straight-line method to write down the cost of investment property to their residual values over their estimated useful lives. The estimated useful lives are as follows:

| | |
|-----------|----------|
| Buildings | 20 years |
|-----------|----------|

2.3.9 Asset classified as held for sale

Non-current assets are classified as Investments – “held for sale” when their carrying amounts will be recovered principally through sale, they are available for sale in their present condition and their sale is highly probable. Non-current assets held for sale are measured at the lower of their carrying amount and fair value less cost to sell, except for those assets and liabilities that are not within the scope of the measurement requirements of SLFRS 5 on “Non-current Assets Held for Sale and Discontinued Operations” such as deferred taxes, financial instruments, investment properties, insurance contracts, and assets and liabilities arising from employee benefits.

2.3.10 Intangible assets

The Bank’s intangible assets include the value of computer software.

(i) Basis of recognition

An intangible asset is recognised only when its cost can be measured reliably and it is probable that the expected future economic benefits that are attributable to it will flow to the Bank in accordance with LKAS 38 on “Intangible Assets”.

Intangible assets acquired separately are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and accumulated impairment losses if any.

(ii) Subsequent expenditure

Subsequent expenditure on intangible asset is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

(iii) Useful economic life, amortisation and impairment

The useful lives of intangible assets are assessed to be either finite or indefinite.

Intangible assets with finite lives are amortised over the useful economic life. The amortisation period and the amortisation method for an intangible asset with a finite useful life are reviewed at least at each financial year end. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are accounted for by changing the amortisation period or method, as appropriate, and they are treated as changes in accounting estimates. The amortisation expense on intangible assets with finite lives is recognised in the income statement in the expense category consistent with the function of the intangible asset.

Amortisation

Amortisation is calculated using the straight-line method to write down the cost of intangible assets to their residual value over their estimated useful life as follows:

| The class of intangible assets | Useful life | Amortisation method |
|--------------------------------|-------------|----------------------|
| Computer software | 7 years | Straight-line method |

The unamortised balances of intangible assets with finite lives are reviewed for impairment whenever there is an indication for impairment and recognised in profit or loss to the extent that they are no longer probable of being recovered from the expected future benefits.

(iv) Derecognition

Intangible assets are derecognised on disposal or when no future economic benefits are expected from their use. Any gain or loss arising on derecognition of the asset, (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is recognised in the profit or loss in the year the asset is derecognised.

2.3.11 Impairment of non-financial assets

The Bank assesses at each reporting date whether there is an indication that an asset may be impaired. If any indication exists, or when annual impairment testing for an asset is required, the Bank estimates the asset’s recoverable amount. An asset’s recoverable amount is the higher of an asset’s or cash-generating unit’s (CGU) fair value less costs to sell and its value in use. Where the carrying amount of an asset or CGU exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. In determining fair value less costs to sell, an appropriate valuation model is used.

For assets, an assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the Bank estimates the asset’s or CGU’s recoverable amount. A previously recognised impairment loss is reversed only if there has been a change in the assumptions used to determine the asset’s recoverable amount since the last impairment loss was recognised. The reversal is limited so that the carrying amount of the asset does not exceed its recoverable amount, nor exceeds the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in the income statement.

2.3.12 Financial guarantees

In the ordinary course of business, the Bank gives financial guarantees, consisting of bank guarantees. Bank guarantees are initially recognised in the Financial Statements (within "other liabilities") at fair value, being the premium received. Subsequent to initial recognition, the Bank's liability under each guarantee is measured at the higher of the amount initially recognised less, when appropriate, cumulative amortisation recognised in the income statement, and the best estimate of expenditure required settling any financial obligation arising as a result of the guarantee. Any increase in the liability relating to financial guarantees is recorded in the income statement in "Credit loss expense". The premium received is recognised in the income statement in "Net fees and commission income" on a straight-line basis over the life of the guarantee.

2.3.13 Provisions

Provisions are recognised when the Bank has a present obligation (legal or constructive) as a result of a past event, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. The expense relating to any provision is presented in the income statement net of any reimbursement.

2.3.14 Retirement Benefit Obligations

(a) Defined Benefit Plan-Gratuity

Based on LKAS 19 on "Employee Benefits", the Bank has adopted the actuarial valuation method for employee benefit liability an actuarial valuation is carried out every year to ascertain the liability. A separate fund is not maintained for this purpose.

The principal assumptions, which have the most significant effects on the valuation, are the rate of discount, rate of increase in salary, rate of turnover at the selected ages, rate of disability, death benefits and expenses.

The liability is measured on an actuarial basis using the projected unit credit method, adjusted for unrecognised actuarial gains and losses. The defined benefit plan liability is discounted using rates equivalent to the market yields at the date of statement of financial position that are denominated in the currency in which benefits will be paid, and that have a maturity approximating to the terms of the related pension liability.

The Bank recognises all actuarial gains and losses arising from the defined benefit plan in other comprehensive income (OCI) and all other expenses related to defined benefit plans are recognised as personnel expenses in income statement.

(b) Defined Contribution Plan – Employees' Provident Fund and Employees' Trust Fund

Employees are eligible for Employees' Provident Fund contributions and Employees' Trust Fund contributions in line with the respective Statutes and Regulations. The Bank contributes a minimum 12% and 3%.

2.3.15 Recognition of Income and expenses

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Bank and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognised.

(a) Interest and similar income and expense

For all financial instruments measured at a amortised cost, interest bearing financial assets classified as available for sale and financial instruments designated at fair value through profit or loss, interest income or expense is recorded using the EIR, which is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The calculation takes into account all contractual terms of the financial instrument (for example, prepayment options) and includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the EIR, but not future credit losses.

The carrying amount of the financial asset or financial liability is adjusted if the Bank revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original EIR and the change in carrying amount is recorded as "Other operating income". However, for a reclassified financial asset for which the Bank subsequently increases its estimates of future cash receipts as a result of increased recoverability of those cash receipts, the effect of that increase is recognised as an adjustment to the EIR from the date of the change in estimate.

Once the recorded value of a financial asset or a group of similar financial assets has been reduced due to an impairment loss, interest income continues to be recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

(b) Fee and commission income

The Bank earns fee and commission income from a diverse range of services it provides to its customers. Fee income can be divided into the following two categories:

- Fee income earned from services that are provided over a certain period of time
- Fees earned for the provision of services over a period of time are accrued over that period. These fees include commission income and asset management, custody and other management and advisory fees.

Loan commitment fees for loans that are likely to be drawn down and other credit related fees are deferred (together with any incremental costs) and recognised as an adjustment to the EIR on the loan. When it is unlikely that a loan will be drawn down, the loan commitment fees are recognised over the commitment period on a straight-line basis.

- Fee income from providing transaction services

Fees arising from negotiating or participating in the negotiation of a transaction for a third party, such as the arrangement of the acquisition of shares or other securities or the purchase or sale of businesses, are recognised on completion of the underlying transaction. Fees or components of fees that are linked to a certain performance are recognised after fulfilling the corresponding criteria.

(c) Dividend income

Dividend income is recognised when the Bank's right to receive the payment is established.

(d) Net operating income

Results arising from trading activities include all gains and losses from changes in fair value and related interest income or expense and dividends for financial assets and financial liabilities "held for trading".

2.3.16 Taxes

(a) Current tax

Current tax assets and liabilities for the current and prior years are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted by the statement of financial position date.

(b) Deferred tax

Deferred tax is provided on temporary differences at the statement of financial position date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. Deferred tax liabilities are recognised for all taxable temporary differences.

Deferred tax assets are recognised for all deductible temporary differences, carry forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry forward of unused tax credits and unused tax losses can be utilised.

The carrying amount of deferred tax assets is reviewed at each statement of financial position date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Unrecognised deferred tax assets are reassessed at each statement of financial position date and are recognised to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the statement of financial position date.

Current tax and deferred tax relating to items recognised directly in equity are also recognised in equity and not in the income statement.

Deferred tax assets and deferred tax liabilities are offset if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

(c) Value Added Tax (VAT) on financial services

Value Added Tax on financial services is calculated in accordance with the Value Added Tax Act No.14 of 2002 and subsequent amendments thereto. The base for the computation of Value Added Tax on financial services is the accounting profit before income tax adjusted for the economic depreciation and emoluments of employees' computed on prescribed rate.

(d) Withholding tax on dividends

Withholding tax on dividends distributed by the Bank that arise from the distribution of dividends of the Bank is recognised at the time of liability to pay the related dividend is recognised. At present, the rate of 14% is deducted at source.

(e) Economic Service Charge (ESC)

As per the provisions of Economic Service Charge Act No. 13 of 2006 and subsequent amendments thereto, the ESC is calculated on liable turnover. Currently, the ESC is payable at 0.5% and is deductible from the income tax payable. Unclaimed ESC, if any, can be carried forward and set-off against the income tax payable in the two subsequent years.

(f) Crop Insurance Levy (CIL)

As per the provisions of Section 14 of the Finance Act No. 12 of 2013, the CIL was introduced with effect from 1 April 2013 and is payable to the National Insurance Trust Fund. Currently, the CIL is payable at 1% of the profit after tax.

(g) Nation Building Tax (NBT) on financial services

According to the Nation Building Tax Act No. 09 of 2009 and subsequent amendments thereto, Nation Building Tax should be paid on the liable turnover. The business of banking or finance is exempted from Nation Building Tax up to 31 December 2013 and the exemption was removed with effect from 1 January 2014. NBT on financial services is calculated as 2% of the value addition used for the purpose of VAT on financial services.

(h) Debts Repayments Levy (DRL)

DRL on financial service is calculated in accordance with the Finance Act No. 35 of 2018 of a period from 1 October 2018 to December 2021. DRL on financial services is calculated based on the total value addition used for the purpose of VAT on financial services. The DRL rate applied in 2018 is 7%.

2.3.17 Grants

Grants are recognised where there is reasonable assurance that the grant will be received and all attached conditions will be complied with. When the grant relates to an expense item, it is recognised as income over the period necessary to match the grant on a systematic basis to the costs that it is intended to compensate. When the grant relates to an asset, it is recognised as deferred income and released to income in equal amounts over the expected useful life of the related asset.

2.3.18 Dividends on ordinary shares

Dividends on ordinary shares are recognised as a liability and deducted from equity when they are approved by the Bank's shareholders. Interim dividends are deducted from equity when they are declared and no longer at the discretion of the Bank.

Dividends for the year that are approved after the statement of financial position date are disclosed as an event after the reporting date.

2.3.19 Equity reserves

The reserves recorded in equity on the Bank's statement of financial position include:

"Available-for-sale" reserve which comprises changes in fair value of available-for-sale investments.

2.3.20 Segment reporting

A segment is a distinguishable component of the Bank that is engaged in providing services (Business segments) or in providing services within a particular economic environment (Geographical segment) which is subject to risks and rewards that are different from those of other segments.

In accordance with the SLFRS 8 on "Segmental Reporting", segmental information is presented in respect of the Bank based on Bank Management and Internal Reporting Structure.

The Bank's segmental reporting is based on the following operating segments.

| | |
|-----------|---------------------------------------------------------------------------------------------------------|
| Banking: | Individual customers' deposits and consumer financing, equipment financing, home and property financing |
| Leasing: | Lease and hire purchase facility customers |
| Treasury: | Placements of funds with other banks and financial institutions, equity investments |
| Pawning: | Pawning advances to customers |

Management monitors the operating results of its business units separately for the purpose of making decisions about resource allocation and performance assessment. Segment performance is evaluated based on operating profit or loss of respective segment.

2.4 Standards issued but not yet effective as at 31 December 2018

The following Sri Lanka Accounting Standards have been issued by The Institute of Chartered Accountants of Sri Lanka which are not yet effective as at 31 December 2018.

SLFRS 16 – Leases

SLFRS 16 sets out the principles for the recognition, measurement, presentation, and disclosure of leases for both parties to a contract, i.e. the customer ("Lessee") and the supplier ("Lessor"). SLFRS 16 will replace Sri Lanka Accounting Standard – LKAS 17 on "Leases" and related interpretations. SLFRS 16 introduces a single accounting model for the lessee, eliminating the present classification of leases in LKAS 17 as either operating leases or finance leases.

The new Standard requires a lessee to:

- recognise assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value
- present depreciation of lease assets separately, from interest on lease liabilities in the income statement.

SLFRS – 16 substantially carries forward the lessor accounting requirement in LKAS – 17. Accordingly, a lessor continues to classify its leases as operating lease or finance lease, and to account for those two types of leases differently.

SLFRS –16 will become effective on 1 January 2019. The Bank is currently assessing the impact on the implementation of the above Standard.

Year ended 31 December

3. Net interest income

| | 2018 LKR | 2017 LKR |
|-------------------------------------------------------------------------|-----------------------|-----------------------|
| Interest income | | |
| Cash and cash equivalents | 60,099,522 | 108,954,586 |
| Placements with banks | 851,002,417 | 791,936,162 |
| Financial assets at amortised cost: | | |
| – Loans and receivables to other customers | 11,955,309,807 | 9,757,778,114 |
| – Debt and other instruments | 250,369,831 | – |
| Financial investments – held to maturity | – | 88,639,079 |
| Other financial asset classified under loans and receivable – Debenture | – | 26,824,825 |
| – Commercial papers | – | 55,155,101 |
| – Trust certificates | – | 45,205 |
| Total interest income | 13,116,781,577 | 10,829,333,073 |
| Interest expenses | | |
| Financial liabilities at amortised cost: | | |
| – Due to other customers | 6,576,577,677 | 5,403,843,692 |
| – Due to debt securities holders | 393,858,241 | – |
| – Other borrowers | 1,453,321,810 | 1,537,996,810 |
| Total interest expenses | 8,423,757,728 | 6,941,840,502 |
| Net interest income | 4,693,023,849 | 3,887,492,571 |

3.1 Net interest income from Sri Lanka Government Securities

| | 2018 LKR | 2017 LKR |
|-----------------------------------------------------------------|--------------------|--------------------|
| Interest income | 149,604,115 | 166,672,805 |
| (Less): Interest expenses | – | – |
| Net interest income from Sri Lanka Government Securities | 149,604,115 | 166,672,805 |

4. Net fee and commission income

| | 2018 LKR | 2017 LKR |
|--------------------------------------|--------------------|--------------------|
| Fee and commission income | 226,767,650 | 278,769,564 |
| Fee and commission expenses | (4,396,881) | (3,511,099) |
| Net fee and commission income | 222,370,769 | 275,258,465 |

4.1 Net fee and commission earned from

| | 2018 LKR | 2017 LKR |
|----------------------------------------|--------------------|--------------------|
| Loans | 98,983,799 | 170,908,206 |
| Deposits | 1,629,265 | 2,346,270 |
| Guarantees | 2,232,754 | 2,107,028 |
| Commission earned from insurance | 18,776,277 | 30,282,769 |
| Commission earned from ATM | 18,652,403 | 18,822,660 |
| Late fees charged from overdue rentals | 30,005,579 | 18,257,833 |
| Others | 52,090,692 | 32,533,699 |
| Net fee and commission income | 222,370,769 | 275,258,465 |

Year ended 31 December

5. Net gain/(loss) from financial instruments at fair value through profit or loss

| | 2018 LKR | 2017 LKR |
|-------------------------------------------------------|--------------------|--------------------|
| Government debt securities – Treasury bills and bonds | (942,414) | 24,727,750 |
| Unit trust | 281,114,474 | 187,031,644 |
| Total | 280,172,060 | 211,759,394 |

6. Net other operating income

| | 2018 LKR | 2017 LKR |
|-----------------------------------------------|-------------------|-------------------|
| Gain on sale of property, plant and equipment | 2,812,163 | 8,901,610 |
| Dividend income | 476,587 | 6,929,443 |
| Account maintenance fees | 16,329,296 | 31,840,402 |
| Other income | 1,193,056 | 3,173,943 |
| Other operating income | 20,811,102 | 50,845,398 |

7. Impairment for loans and other losses**7.1 Balance with Bank**

| | 2018 LKR | 2017 LKR |
|--------------|----------------|-------------|
| Stage 1 | 606,166 | – |
| Total | 606,166 | – |

7.2 Placement with banks

| | 2018 LKR | 2017 LKR |
|--------------|------------------|-------------|
| Stage 1 | 5,671,770 | – |
| Total | 5,671,770 | – |

7.3 Financial assets at amortised cost – Loans and receivables to customers

| | 2018 LKR | 2017 LKR |
|--------------|--------------------|-------------|
| Stage 1 | (9,390,783) | – |
| Stage 2 | 48,205,067 | – |
| Stage 3 | 480,902,288 | – |
| Total | 519,716,573 | – |

7.4 Debt and other instruments

| | 2018 LKR | 2017 LKR |
|--------------|------------------|-------------|
| Stage 1 | (150,628) | – |
| Total | (150,628) | – |

Year ended 31 December

| | 2018 LKR | 2017 LKR |
|-----------------------------------------|--------------------|--------------------|
| 7.5 Collective impairment losses | – | 289,822,414 |
| Individual impairment losses | – | 3,714,495 |
| Total | – | 293,536,909 |
| Gross total | 525,843,881 | 293,536,909 |

8. Personnel expenses

| | 2018 LKR | 2017 LKR |
|---------------------------------------------------|----------------------|----------------------|
| Salary and bonus | 1,343,605,896 | 1,070,931,842 |
| Contributions to defined contribution plans – EPF | 178,360,466 | 134,946,361 |
| – ETF | 38,216,904 | 28,916,026 |
| Contributions to defined benefit plans | 54,590,639 | 51,924,037 |
| Overtime | 7,932,044 | 4,964,266 |
| Staff welfare | 26,607,544 | 20,800,381 |
| Staff allowances | 78,858,344 | 76,442,284 |
| Others | 98,901,512 | 85,220,669 |
| Total | 1,827,073,349 | 1,474,145,865 |

9. Depreciation and amortisation expenses

| | 2018 LKR | 2017 LKR |
|-----------------------------------------------|--------------------|--------------------|
| Depreciation of property, plant and equipment | 218,783,787 | 181,731,039 |
| Depreciation of investment property | 1,056,030 | 1,056,030 |
| Amortisation of intangible assets | 4,420,615 | 8,789,904 |
| Total | 224,260,432 | 191,576,973 |

10. Other expenses

| | 2018 LKR | 2017 LKR |
|--------------------------------------------------|----------------------|----------------------|
| Directors' emoluments | 19,660,000 | 21,200,000 |
| Auditors' remuneration | 4,000,000 | 3,359,156 |
| Professional and legal expenses | 1,495,216 | 5,785,537 |
| Office administration and establishment expenses | 1,500,976,636 | 1,333,706,488 |
| Total | 1,526,131,852 | 1,364,051,181 |

10.1 Directors' Emoluments include fees paid to Non-Executive Directors.

Year ended 31 December

11. Tax expense

| | 2018 LKR | 2017 LKR |
|--------------------------------------------------------------|--------------------|--------------------|
| Current tax expense | | |
| Income tax for the year | 341,234,017 | 251,970,411 |
| Adjustment in respect of current income tax of prior periods | 46,084,930 | (17,756,147) |
| Deferred taxation charge/(reversal) | (100,126,593) | 10,563,313 |
| Total | 287,192,354 | 244,777,577 |

11.1 Reconciliation of tax expenses

| | 2018 LKR | 2017 LKR |
|----------------------------------------------------------------------|--------------------|--------------------|
| Profit before tax | 644,142,473 | 752,601,109 |
| Income tax for the period (Accounting profit @ 28%) | 180,359,893 | 210,728,310 |
| Income exempt from tax | (36,886,787) | (69,724,667) |
| Adjustment in respect of current income tax of prior periods | 46,084,930 | (17,756,147) |
| Add: Tax effect of expenses that are not deductible for tax purposes | 778,552,158 | 183,744,896 |
| Less: Tax effect of expenses that are deductible for tax purposes | (520,532,902) | (89,568,327) |
| Add: Tax impact on leasing loss | (60,258,345) | 16,790,198 |
| Tax expense for the period | 387,318,947 | 234,214,264 |
| Deferred taxation charge | (100,126,593) | 10,563,313 |
| At the effective income tax rate of 44.59% (2017 : 32.52%) | 287,192,354 | 244,777,577 |

11.2 Deferred tax assets, liabilities and income tax relates to the followings:

| | Statement of financial position | | Statement of comprehensive income | |
|------------------------------------------------------|---------------------------------|--------------------|-----------------------------------|---------------------|
| | 2018 LKR | 2017 LKR | 2018 LKR | 2017 LKR |
| Deferred tax liability | | | | |
| Capital allowances for property, plant and equipment | 15,637,704 | 24,008,134 | (8,370,430) | (494,566) |
| Capital allowances for leased assets | 148,218,327 | 185,228,090 | (37,009,763) | 36,154,440 |
| | 163,856,031 | 209,236,224 | (45,380,193) | 35,659,874 |
| Deferred tax assets | | | | |
| Defined benefit plans | 99,359,246 | 72,001,044 | (27,358,202) | (12,502,650) |
| Loss on lease assets | - | 79,234,788 | 79,234,788 | (11,786,090) |
| Impairment allowances | 133,911,711 | - | (133,911,711) | - |
| | 233,270,957 | 151,235,832 | (82,035,125) | (24,288,740) |
| Deferred taxation charge | | | (127,415,319) | 11,371,134 |
| Net deferred tax liability/(asset) | (69,414,926) | 58,000,392 | | |

Year ended 31 December

11.2.1 Composition of deferred tax charge

| | 2018 LKR | 2017 LKR |
|-----------------------------------------|----------------------|-------------------|
| Impact on income tax expense | (100,126,593) | 10,563,313 |
| Impact on other comprehensive income | (12,878,686) | 807,821 |
| Impact on comprehensive income | (113,005,279) | 11,371,134 |
| Impact on opening balance under SLFRS 9 | (14,410,040) | – |
| Total impact | (127,415,319) | 11,371,134 |

12. Earnings per share

Basic earnings per share amounts are calculated by dividing the net profit for the year attributable to ordinary shareholders (after deducting preference share dividends, if any) by the weighted average number of ordinary shares outstanding during the year. The weighted average number of ordinary shares outstanding during the year and the previous year are adjusted for events that have changed the number of ordinary shares outstanding, without a corresponding change in the resources such as a scrip dividend.

| | 2018 LKR | 2017 LKR |
|----------------------------------------------|-------------|-------------|
| Net profit for the period | 356,950,119 | 507,823,532 |
| Profit attributable to ordinary shareholders | 356,950,119 | 507,823,532 |

| | 2018 Number | 2017 Number |
|-----------------------------------------------------|----------------|----------------|
| Weighted average number of ordinary shares in issue | 56,308,252 | 51,429,758 |
| | 56,308,252 | 51,429,758 |
| Basic/diluted earnings per ordinary share | 6.34 | 9.87 |

The subordinated term debts detailed in Note No. 27 are resulted for anti-diluted earning per share.

13. Cash and cash equivalents

| | 2018 LKR | 2017 LKR |
|---------------------|----------------------|----------------------|
| Cash in hand | 424,829,523 | 302,643,017 |
| Balances with banks | 3,747,730,463 | 887,746,589 |
| Less: impairment | (621,356) | – |
| Total | 4,171,938,630 | 1,190,389,606 |

13.1 The below table shows the analysis of cash and cash equivalents based on exposure to credit risk:

| | 2018 | |
|----------------------------------|----------------------|----------------------|
| | Stage 1 LKR | Total LKR |
| Placements | 4,172,559,986 | 4,172,559,986 |
| Less: Impairment | (621,356) | (621,356) |
| Balance as at 31 December | 4,171,938,630 | 4,171,938,630 |

Year ended 31 December

13.2 The below table shows the stage-wise classification of impairment allowances:

| | 2018 LKR | 2017 LKR |
|------------------------------------------|----------------|-------------|
| Stage 1 | | |
| Opening balance as at 1 January | 15,190 | – |
| Changes/(Write back) to income statement | 606,166 | – |
| Closing balance as at 31 December | 621,356 | – |

13.3 Cash and cash equivalents for cash flow statement

| | 2018 LKR | 2017 LKR |
|---------------------------------------|-----------------------|----------------------|
| Cash and cash equivalents | 4,171,938,630 | 1,190,389,606 |
| Repurchase agreement | 2,934,221,630 | 715,158,613 |
| Fixed deposits less than three months | 9,509,742,123 | 4,681,347,603 |
| | 16,615,902,383 | 6,586,895,822 |

14. Placements with banks

| | 2018 LKR | 2017 LKR |
|---------------------------------|----------------------|----------------------|
| Placement with Banks | 9,535,897,658 | 6,014,703,836 |
| Total | 9,535,897,658 | 6,014,703,836 |
| Less: impairment | (7,472,093) | – |
| Carrying value after impairment | 9,528,425,565 | 6,014,703,836 |

14.1 The below table shows the stage-wise classification of placement and the impairment allowance:

| | 2018 | |
|---------------------------------------------------|----------------------|----------------------|
| | Stage 1 LKR | Total LKR |
| Placement | 9,535,897,658 | 9,535,897,658 |
| Less: Impairment allowance for placement | (7,472,093) | (7,472,093) |
| Carrying value after impairment as at 31 December | 9,528,425,565 | 9,528,425,565 |

14.2 The below table shows the stage wise classification of impairment allowances:

| | 2018 LKR | 2017 LKR |
|------------------------------------------|------------------|-------------|
| Stage 1 | | |
| Opening balance as at 1 January | 1,800,323 | – |
| Charges/(write back) to income statement | 5,671,770 | – |
| Closing balance as at 31 December | 7,472,093 | – |

Year ended 31 December

15. Other financial assets at fair value through profit or loss

| | 2018 LKR | 2017 LKR |
|--------------------------------------------------|--------------------|----------------------|
| Sri Lanka Government Securities – Treasury Bonds | – | 337,940,600 |
| Quoted equities (Note 15.1) | – | 20,567,010 |
| Unit trust | 146,103,330 | 4,115,297,963 |
| Total | 146,103,330 | 4,473,805,573 |

15.1 Quoted equities

| | 2018 | | 2017 | |
|-------------------------------|------------------|---------------------|------------------|---------------------|
| | Number of shares | Market value LKR | Number of shares | Market value LKR |
| John Keells Holdings PLC | – | – | 25,800 | 3,831,300 |
| Hatton National Bank PLC | – | – | 5,300 | 1,033,500 |
| Aitken Spence PLC | – | – | 72,600 | 3,963,960 |
| DFCC Bank | – | – | 17,345 | 2,129,966 |
| National Development Bank PLC | – | – | 36,571 | 4,988,284 |
| Tokyo Cement PLC | – | – | 70,000 | 4,620,000 |
| | – | – | – | 20,567,010 |

16. Financial assets at amortised cost – Loan and receivable to other customers

| | 2018 LKR | 2017 LKR |
|-----------------------------------------|-----------------------|-----------------------|
| Gross loans and receivables (Note 16.1) | 79,482,459,527 | 68,104,871,364 |
| Less: impairment | (1,975,438,365) | (1,417,455,771) |
| Net loans and advances | 77,507,021,162 | 66,687,415,593 |
| Gross loans and receivables (Note 16.1) | 79,482,459,527 | 68,104,871,364 |
| Less: Individual impairment | (350,360,455) | (220,946,259) |
| Collective impairment | (1,625,077,910) | (1,196,509,512) |
| Net loans and advances | 77,507,021,162 | 66,687,415,593 |

Year ended 31 December

16.1 The below table shows the analysis of cash and cash equivalents based on exposure to credit risk:

| | Stage 1 | Stage 2 | Stage 3 | Total |
|------------------------------------------|-----------------------|----------------------|----------------------|-----------------------|
| Significant impairment loans | | | | |
| Term loan | – | – | 1,000,469,342 | 1,000,469,342 |
| Leasing | – | – | 145,961,745 | 145,961,745 |
| Collective impairment loans | | | | |
| Pawning | 1,187,539,873 | 56,887,961 | 13,850,772 | 1,258,278,606 |
| Cash margin | 5,134,496,941 | 430,882,184 | 8,813,039 | 5,574,192,164 |
| Staff loans | 1,097,737,911 | – | 23,866,152 | 1,121,604,063 |
| Term loans | | | | |
| Business | 7,763,492,734 | 1,161,498,837 | 595,625,756 | 9,520,617,327 |
| Cooperative | 2,133,338,868 | 111,133,683 | 287,054,035 | 2,531,526,586 |
| Housing | 2,200,895,413 | 453,150,141 | 240,483,984 | 2,894,529,538 |
| Personal | 47,665,057,056 | 1,126,826,518 | 1,553,195,979 | 50,345,079,553 |
| Lease rentals | 3,562,166,844 | 1,295,727,450 | 232,306,309 | 5,090,200,603 |
| Gross loans and advances | 70,744,725,640 | 4,636,106,774 | 4,101,627,113 | 79,482,459,527 |
| Less : impairment allowance | (318,278,117) | (269,805,490) | (1,387,354,758) | (1,975,438,365) |
| Closing balance as at 31 December | 70,426,447,523 | 4,366,301,284 | 2,714,272,355 | 77,507,021,162 |

16.2 By product

| | 2018 LKR | 2017 LKR |
|---------------------------|-----------------------|-----------------------|
| Loans and advances | | |
| Pawning | 1,258,278,606 | 834,073,305 |
| Cash margin | 5,574,192,164 | 4,450,768,626 |
| Staff loans | 1,121,604,063 | 909,505,218 |
| Lease rentals receivable | 5,236,162,349 | 4,364,186,223 |
| Term loans | – | 57,546,337,993 |
| Business | 10,248,947,436 | – |
| Cooperative | 2,682,172,444 | – |
| Housing | 2,971,196,180 | – |
| Personal | 50,389,906,285 | – |
| Gross total | 79,482,459,527 | 68,104,871,364 |

16.2.1 Lease rentals receivable

| | 2018 LKR | 2017 LKR |
|-----------------------------------------|----------------------|----------------------|
| Within one year | 2,896,844,537 | 2,547,227,240 |
| One to five years | 3,890,404,144 | 3,036,753,747 |
| After five years | 35,539,483 | 21,244,121 |
| – Unearned income on rentals receivable | (1,586,625,815) | (1,241,038,885) |
| | 5,236,162,349 | 4,364,186,223 |

Year ended 31 December

16.3 By currency

| | 2018 LKR | 2017 LKR |
|--------------------|-----------------------|-----------------------|
| Sri Lankan Rupee | 79,482,459,527 | 68,104,871,364 |
| Gross total | 79,482,459,527 | 68,104,871,364 |

16.4 Movements in individual and collective impairment during the year

| | 2018 LKR | 2017 LKR | |
|------------------------------------------------------------|---------------------------------|---------------------------------|----------------------------|
| Stage 1 | | | |
| Opening balance as at 1 January | 327,668,900 | - | |
| Changes/(Write back) to income statement | (9,390,783) | - | |
| Closing balance as at 31 December | 318,278,117 | - | |
| Stage 2 | | | |
| Opening balance as at 1 January | 221,600,423 | - | |
| Charges/(Write back) to income statement | 48,205,067 | - | |
| Closing balance as at 31 December | 269,805,490 | - | |
| Stage 3 | | | |
| Opening balance as at 1 January | 917,503,123 | - | |
| Charges/(Write back) to income statement | 480,902,288 | - | |
| Write-off during the year | (11,050,653) | - | |
| Closing balance as at 31 December | 1,387,354,758 | - | |
| | Individual impairment LKR | Collective impairment LKR | Total impairment LKR |
| As at 1 January 2017 | 217,231,764 | 914,805,585 | 1,132,037,349 |
| Charge to income statement | 3,714,495 | 289,822,414 | 293,536,909 |
| Write-off during the year | - | (8,118,487) | (8,118,487) |
| As at 31 December 2017 | 220,946,259 | 1,196,509,512 | 1,417,455,771 |
| As at 31 December 2017 | 220,946,259 | 1,196,509,512 | 1,417,455,771 |
| Impact of adoption of SLFRS 9 (Note 43) | - | 49,316,676 | 49,316,676 |
| Restated balance under SLFRS 9 as at 1 January 2018 | 220,946,259 | 1,245,826,188 | 1,466,772,447 |
| Charge/(Write back) to income statement | 129,414,196 | 390,302,377 | 519,716,573 |
| Recovery/(Write-off) during the year | - | (11,050,655) | (11,050,655) |
| As at 31 December 2018 | 350,360,455 | 1,625,077,910 | 1,975,438,365 |

Year ended 31 December

17. Financial assets at amortised cost – Debt and other instruments

| | 2018 LKR | 2017 LKR |
|----------------------|----------------------|-------------|
| Debentures | 174,804,870 | – |
| Repurchase agreement | 2,934,221,630 | – |
| Treasury bill | 296,755,397 | – |
| Less: Impairment | (181,611) | – |
| Total | 3,405,600,286 | – |

17.1 The below table shows the analysis of debt and other instruments based on exposure to credit risk:

| | 2018 | |
|------------------------------------------|---------------|---------------|
| | Stage 1 | Total |
| Debentures | 174,804,870 | 174,804,870 |
| Repurchase agreement | 2,934,221,630 | 2,934,221,630 |
| Treasury bill | 296,755,397 | 296,755,397 |
| Less: Impairment allowance for placement | (181,611) | (181,611) |
| Closing balance as at 31 December | 3,405,600,286 | 3,405,600,286 |

17.2 The below table shows the stage wise classification of impairment allowance:

| | 2018 LKR |
|--------------------------------------------------|----------------|
| Stage 1 | |
| Opening balance as at 1 January | 332,239 |
| Charge/(Reversal) to statement of profit of loss | (150,628) |
| Net write-off during the year | – |
| Closing balance as at 31 December | 181,611 |

17.3 Other financial asset classified under loans and receivable

| | 2018 LKR | 2017 LKR |
|----------------------|-------------|----------------------|
| Debentures | – | 174,767,627 |
| Commercial papers | – | 590,023,387 |
| Repurchase agreement | – | 715,158,613 |
| Total | – | 1,479,949,628 |

17.4 Financial investment held to maturity

| | 2018 LKR | 2017 LKR |
|----------------------------------------|-------------|--------------------|
| Sri Lanka Government Securities | | |
| Treasury bill | – | 48,069,096 |
| Treasury bond | – | 200,930,556 |
| Inv – debenture repo | – | 350,551,370 |
| Held-to-maturity investments | – | 599,551,022 |

Year ended 31 December

18. Financial assets measured at fair value through other comprehensive income

| | 2018 LKR | 2017 LKR |
|-----------------------------------------------------------------------------------|-------------------|-------------|
| Equities – unquoted (Note 18.1) | 60,148,048 | – |
| Financial assets measured at fair value through other comprehensive income | 60,148,048 | – |

Financial investments – available for sale

| | 2018 LKR | 2017 LKR |
|-------------------------------------------|-------------|-------------------|
| Equities – unquoted (Note 18.1) | – | 63,536,159 |
| Net available-for-sale investments | – | 63,536,159 |

18.1 Equities – unquoted

| | 2018 | | 2017 | |
|-------------------------------------------------------------------|------------------|-------------------|------------------|-------------------|
| | Number of shares | Amount LKR | Number of shares | Amount LKR |
| SANASA Insurance Company Limited | 7,590,494 | 75,904,944 | 7,590,494 | 75,904,944 |
| Credit Information Bureau of Sri Lanka | 100 | 10,000 | 100 | 10,000 |
| Consorzio Etimos S.C. | 2 | 75,194 | 2 | 75,194 |
| Loss from mark to market valuation as at 31 December market value | | (15,842,090) | | (12,453,979) |
| | | 60,148,048 | | 63,536,159 |

18.1.1 Unquoted equity securities accounted as financial investments – Available for sale

| | 2018 LKR | 2017 LKR |
|------------------------------------|-------------------|-------------------|
| Opening balance as at 1 January | 63,536,159 | 63,686,559 |
| Disposal during the year | – | (100,000) |
| Loss from mark to market valuation | (3,388,111) | (50,400) |
| Balance as at 31 December | 60,148,048 | 63,536,159 |

| Type | Level | Method of valuation | Significant unobservable inputs | Sensitivity of fair value to unobservable inputs |
|---------------------------|---------|--------------------------------------------------------------------|-----------------------------------------------|--------------------------------------------------|
| Unquoted share investment | Level 3 | Market approach – price to book value of comparable peer companies | Median price to book value-liquidity discount | Positively correlated sensitivity |
| | | | Regulatory non-compliance adjustment | Positively correlated sensitivity |

19. Asset classified as held for sale

| | 2018 LKR | 2017 LKR |
|-----------------------------------|-------------|-------------|
| Asset classified as held for sale | – | 37,175,411 |
| | – | 37,175,411 |

Assets classified as held for sale include land and building located in Galle. These land and building sold amount of LKR 39,000,000.00, and capital gain was LKR 1,797,589.00.

Year ended 31 December

20. Property, plant and equipment

| 2018 | Land and buildings LKR | Leasehold properties LKR | Computer hardware LKR | Machinery and equipment LKR | Furniture and fittings LKR | Vehicle LKR | Total LKR | |
|--------------------------------------------|---------------------------|-----------------------------|--------------------------|--------------------------------|-------------------------------|--------------------|-------------------------|--------------------|
| Cost | | | | | | | | |
| Opening balance at 1 January 2018 | 251,979,214 | 590,000 | 678,783,946 | 480,614,783 | 325,426,778 | 145,774,508 | 1,883,169,229 | |
| Additions | – | – | 104,758,145 | 33,466,175 | 66,557,679 | 12,152,546 | 216,934,546 | |
| Disposals | – | – | (13,149,277) | (12,065,666) | (16,572,410) | (2,105,323) | (43,892,676) | |
| Closing balance at 31 December 2018 | 251,979,214 | 590,000 | 770,392,814 | 502,015,293 | 375,412,047 | 155,821,731 | 2,056,211,099 | |
| Less: Accumulated depreciation | | | | | | | | |
| Opening balance at 1 January 2018 | 29,721,712 | 590,000 | 481,626,273 | 363,356,943 | 194,351,555 | 104,837,167 | 1,174,483,649 | |
| Charge for the year | 1,875,385 | – | 109,850,005 | 42,348,288 | 43,880,560 | 20,829,549 | 218,783,787 | |
| Disposals | – | – | (12,879,450) | (10,756,449) | (16,053,609) | (2,105,323) | (41,794,831) | |
| Closing balance at 31 December 2018 | 31,597,097 | 590,000 | 578,596,828 | 394,948,782 | 222,178,506 | 123,561,393 | 1,351,472,605 | |
| 2017 | | | | | | | | |
| 2017 | Land and buildings LKR | Leasehold properties LKR | Computer hardware LKR | Machinery and equipment LKR | Furniture and fittings LKR | Vehicle LKR | Total LKR | |
| Cost | | | | | | | | |
| Opening balance at 1 January 2017 | 251,979,214 | 590,000 | 555,573,790 | 437,472,261 | 264,479,129 | 134,909,319 | 1,645,003,714 | |
| Additions | – | – | 128,998,228 | 50,796,018 | 69,612,983 | 23,378,900 | 272,786,130 | |
| Disposals | – | – | (5,788,072) | (7,653,496) | (8,665,335) | (12,513,711) | (34,620,614) | |
| Closing balance at 31 December 2017 | 251,979,214 | 590,000 | 678,783,946 | 480,614,783 | 325,426,778 | 145,774,508 | 1,883,169,230 | |
| Less: Accumulated depreciation | | | | | | | | |
| Opening balance at 1 January 2017 | 25,776,982 | 560,500 | 404,293,970 | 326,329,747 | 168,310,339 | 100,256,053 | 1,025,527,590 | |
| Charge for the year | 3,944,730 | 29,500 | 83,045,664 | 43,305,166 | 34,311,153 | 17,094,825 | 181,731,039 | |
| Disposals | – | – | (5,713,361) | (6,277,970) | (8,269,937) | (12,513,711) | (32,774,980) | |
| Closing balance at 31 December 2017 | 29,721,712 | 590,000 | 481,626,273 | 363,356,943 | 194,351,555 | 104,837,167 | 1,174,483,649 | |
| | | | | | | 2018 | 2017 | |
| | | | | | | LKR | LKR | |
| Work in progress | | | | | | | | |
| Building | | | | | | – | 17,787,049 | |
| | | | | | | – | 17,787,049 | |
| | Land and buildings LKR | Leasehold properties LKR | Computer hardware LKR | Machinery and equipment LKR | Furniture and fittings LKR | Vehicle LKR | Work in progress LKR | Total LKR |
| Net book value at 31 December 2018 | 220,382,118 | – | 191,795,986 | 107,066,511 | 153,233,541 | 32,260,338 | – | 704,738,493 |
| Net book value at 31 December 2017 | 222,257,503 | – | 197,157,673 | 117,257,840 | 131,075,223 | 40,937,341 | 17,787,049 | 726,472,629 |

Year ended 31 December

20.1 Freehold land and buildings

The details of the land and building owned by the Bank are as follows:

| Location/Address | Extent | | 31 December 2018 Cost | | 31 December 2017 Cost | |
|------------------------------------------------------|--------------------|---------------------------|--------------------------|-----------------|--------------------------|-----------------|
| | Land (Purchase) | Building (Square feet) | Land LKR | Building LKR | Land LKR | Building LKR |
| No. 14, Edmonton Road, Kirulapone | 17.85 | – | 38,999,000 | – | 38,999,000 | – |
| No. 12/01, Edmonton Road, Kirulapone | 18.05 | – | 46,799,000 | – | 46,799,000 | – |
| A1, SANASA Housing Project, Toppass, Nuwara Eliya | 14 | 1,200 | 400,000 | 2,100,000 | 400,000 | 2,100,000 |
| No. 145, Rathnapura Road, Horana | 13 | 5,956 | 20,539,000 | 6,500,000 | 20,539,000 | 6,500,000 |
| No. 63A, Matara Road, Akuressa | 14 | 3,728 | 14,423,820 | 8,975,180 | 14,423,820 | 8,975,180 |
| No. 255, Sunnysaid Garden, Karapitiya | 18.5 | 5,992 | 9,250,000 | 20,833,360 | 9,250,000 | 20,833,360 |
| No. 342, Main Street, Kegalle | 13.25 | 5,580 | 34,760,400 | 14,118,600 | 34,760,400 | 14,118,600 |
| No. 6 /176, Walauwatta, Kegalle | 20 | – | 16,639,000 | – | 16,639,000 | – |
| No. 5 /176, Walauwatta, Kegalle | 12 | 1,334 | 8,400,000 | 1,250,000 | 8,400,000 | 1,250,000 |
| No. 149, Abdul Wahab Mw, Galle | 25 | 13,024 | – | – | 4,775,000 | 12,350,609 |
| SANASA Campus Ltd., Paragammana, Hettimulla, Kegalle | 320 | 2,600 | 1,002,912 | 4,568,824 | 1,002,912 | 4,568,824 |
| 60/65, Sahasapura Scheme, Baseline Mw, Borella | – | 1,006 | – | 2,420,118 | – | 2,420,118 |
| | | | 191,213,132 | 60,766,082 | 195,988,132 | 73,116,691 |

20.2 During the financial year, the Company acquired Property, Plant and Equipment to the aggregate value of LKR 216,934,546.00 (2017 – LKR 272,786,130.00). Cash payments amounting to LKR 216,934,546.00 (2017 – LKR 272,786,130.00) were made during the year for purchase of property, plant and equipment.

20.3 Property, plant and equipment includes fully depreciated assets having a gross carrying amount of LKR 1,040,724,692.00 (2017 – LKR 1,005,246,056.00)

20.4 There were no restrictions on the title of the property, plant and equipment as at 31 December 2018.

20.5 There were no idle property, plant and equipment as at 31 December 2018.

21. Investments properties

| | 2018 LKR | 2017 LKR |
|----------------------------------------------|-------------|-------------|
| Cost | | |
| Balance at the beginning of the year | 35,359,000 | 35,359,000 |
| Additions | – | – |
| Balance at the end of the year | 35,359,000 | 35,359,000 |
| Less: Accumulated depreciation | | |
| Balance at the beginning of the year | 11,968,340 | 10,912,310 |
| Charge for the year | 1,056,030 | 1,056,030 |
| Balance at the end of the year | 13,024,370 | 11,968,340 |
| Net book value at the end of the year | 22,334,630 | 23,390,660 |

Year ended 31 December

21.1 The details of the investment property owned by the Bank are as follows:

| Location/Address | Extent | | 31 December 2018 Cost | | 31 December 2017 Cost | |
|----------------------------------|--------------------|---------------------------|--------------------------|-----------------|--------------------------|-----------------|
| | Land (Purchase) | Building (Square feet) | Land LKR | Building LKR | Land LKR | Building LKR |
| No. 6 A/176, Walauwatta, Kegalle | 28 | 8,233.5 | 14,238,400 | 21,120,600 | 14,238,400 | 21,120,600 |
| | | | 14,238,400 | 21,120,600 | 14,238,400 | 21,120,600 |

21.2 There were no direct operating expenses arising from investment property that generated retain income and that did not generate material rental income.

21.3 Assets classified as investment properties include land and building located in Kegalle. Market value (Level 3) of the above assets is LKR 52,788,900.00. Valuation was carried out by R M W N K Chandrasekara independent Professional Valuer.

22. Intangible assets

| | 2018 LKR | 2017 LKR |
|----------------------------------------------|--------------------|--------------------|
| Cost | | |
| Balance at the beginning of the year | 211,929,704 | 211,929,704 |
| Additions | - | - |
| Balance at the end of the year | 211,929,704 | 211,929,704 |
| Less: Accumulated amortisation | | |
| Balance at the beginning of the year | 203,781,364 | 194,991,460 |
| Charge for the year | 4,420,615 | 8,789,904 |
| Balance at the end of the year | 208,201,979 | 203,781,364 |
| Net book value at the end of the year | 3,727,725 | 8,148,340 |

22.1 There were no idle Intangible assets as at 31 December 2018.

22.2 There were no restrictions on the title of the intangible assets as at 31 December 2018.

23. Other assets

| | 2018 LKR | 2017 LKR |
|--------------------------------------------|----------------------|----------------------|
| Postage legal and other charges receivable | 55,628,494 | 85,814,742 |
| VAT receivable | 7,314,404 | 4,670,565 |
| Prepaid staff cost | 635,701,610 | 556,212,985 |
| Deposits and prepayments | 425,178,412 | 361,361,223 |
| Inventory | 74,491,470 | 62,115,332 |
| Total | 1,198,314,390 | 1,070,174,846 |

Year ended 31 December

24. Due to other customers

| | 2018 LKR | 2017 LKR |
|-------------------------------------|-----------------------|-----------------------|
| Total amount due to other customers | 67,474,821,535 | 59,904,734,365 |
| Total | 67,474,821,535 | 59,904,734,365 |

24.1 Analysis

| | 2018 LKR | 2017 LKR |
|-------------------|-----------------------|-----------------------|
| By product | | |
| Savings deposits | 12,369,442,964 | 10,367,022,523 |
| Fixed deposits | 55,105,378,571 | 49,537,711,842 |
| Total | 67,474,821,535 | 59,904,734,365 |

| | 2018 LKR | 2017 LKR |
|--------------------|-----------------------|-----------------------|
| By currency | | |
| Sri Lankan rupee | 67,474,821,535 | 59,904,734,365 |
| Total | 67,474,821,535 | 59,904,734,365 |

25. Other borrowings

| | 2018 LKR | 2017 LKR |
|------------------------------------|-----------------------|----------------------|
| Term loan (Note 25.1) | 12,347,696,633 | 5,320,976,437 |
| Securitised borrowings (Note 25.2) | 827,867,887 | 1,329,718,451 |
| Refinance borrowing (Note 25.3) | 2,245,403,442 | 2,176,914,716 |
| Total | 15,420,967,962 | 8,827,609,604 |

Year ended 31 December

25.1 Term loan – Details

| Institution | Fixed/ Floating | Tenure months | 2018 LKR | 2017 LKR |
|----------------------------------|--------------------|------------------|----------------|---------------|
| National Savings Bank | Floating | 48 | 458,077,389 | 708,621,084 |
| National Savings Bank | Floating | 48 | 1,833,200,000 | – |
| Sampath Bank PLC | Floating | 60 | 158,658,090 | 258,865,164 |
| Sampath Bank PLC | Floating | 60 | 158,658,090 | 258,865,164 |
| Sampath Bank PLC | Floating | 60 | 300,675,854 | 400,878,338 |
| Sampath Bank PLC | Floating | 60 | 317,382,295 | 417,583,273 |
| Seylan Bank PLC | Floating | 22 | 38,094,448 | 302,834,016 |
| Seylan Bank PLC | Floating | 60 | 823,023,219 | 503,236,986 |
| DFCC Bank | Floating | 48 | 489,776,081 | – |
| DFCC Bank | Floating | 48 | 448,974,730 | – |
| Pan Asia Banking Corporation PLC | Floating | 60 | – | 248,283,332 |
| Peoples Bank | Floating | 60 | 786,169,108 | 1,215,226,882 |
| MCB Bank Ltd. | Floating | 60 | 141,502,782 | 191,685,397 |
| HNB Bank PLC | Floating | 48 | 564,330,767 | 814,896,800 |
| HNB Bank PLC | Floating | 48 | 1,469,852,568 | – |
| NDB Bank PLC | Fixed/Floating | 3 | 1,013,227,397 | – |
| IFC | Fixed | 60 | 2,415,304,500 | – |
| FMO | Floating | 52 | 930,789,315 | – |
| | | | 12,347,696,633 | 5,320,976,437 |

25.1.1 Term loan – Movement

| | Opening balance 1 January 2018 LKR | Obtained during year LKR | Repayment LKR | Closing balance 31 December 2018 LKR |
|----------------------------------|------------------------------------------|--------------------------------|------------------|--------------------------------------------|
| National Savings Bank | 708,100,000 | 2,000,000,000 | (417,000,000) | 2,291,100,000 |
| Sampath Bank PLC | 1,333,280,000 | – | (400,032,000) | 933,248,000 |
| Seylan Bank PLC | 802,000,000 | 500,000,000 | (442,950,000) | 859,050,000 |
| Pan Asia Banking Corporation PLC | 248,000,000 | – | (248,000,000) | – |
| Peoples Bank | 1,207,846,115 | – | (426,298,629) | 781,547,486 |
| MCB Bank Ltd. | 191,550,000 | – | (50,100,000) | 141,450,000 |
| HNB Bank PLC | 812,530,000 | 1,500,000,000 | (281,210,000) | 2,031,320,000 |
| NDB Bank PLC | – | 3,100,000,000 | (2,100,000,000) | 1,000,000,000 |
| DFCC Bank | – | 1,000,000,000 | (62,500,002) | 937,499,998 |
| FMO | – | 925,530,757 | – | 925,530,757 |
| IFC | – | 2,331,000,000 | – | 2,331,000,000 |
| Interest payable | 17,670,321 | – | – | 115,950,393 |
| | 5,320,976,436 | 11,356,530,757 | (4,428,090,631) | 12,347,696,633 |

Year ended 31 December

25.2 Securitised borrowings

| | 2018 LKR | 2017 LKR |
|---------|--------------------|----------------------|
| Trust 1 | 4,269,292 | 103,588,703 |
| Trust 2 | 823,598,595 | 1,226,129,748 |
| | 827,867,887 | 1,329,718,451 |

25.3 Refinance borrowing

| | 2018 LKR | 2017 LKR |
|-------------------------------------------------------|----------------------|----------------------|
| SANASA Federation (Refinance of <i>Athwela</i> Loans) | 54,200,000 | 54,200,000 |
| Central Bank of Sri Lanka (RERED) | 3,930,019 | 7,809,688 |
| Central Bank of Sri Lanka (<i>Susahana</i>) | 80,827 | 80,827 |
| Asian Development Bank (<i>Dasuna</i>) | 191,488 | 4,585,032 |
| Borrowings under CBSL – Perennial Crops | – | 306,675 |
| Borrowings under CBSL – Tea Development | 103,530 | 785,148 |
| Borrowings under Refinance of <i>Jayatha</i> | 441,306,600 | 365,602,250 |
| Borrowing under Awakening East | 30,123,850 | 122,544,550 |
| Borrowing under Awakening North | 1,671,750 | 7,346,250 |
| Borrowing under <i>Saubagya</i> | 1,246,363,283 | 1,119,347,996 |
| Borrowing under SPENDP | 408,000 | 1,108,000 |
| Borrowing – Refinance Smile iii | 434,120,501 | 481,693,300 |
| Borrowing – Refinance Nadep | – | – |
| Borrowing – Refinance Sepi | 2,700,000 | 375,000 |
| Borrowing – <i>Suwashakthi</i> Loan | 3,848,997 | 11,130,000 |
| Borrowing – <i>Athwela</i> (READ) | 25,516,667 | – |
| Borrowing – <i>Kapruka Ayojana</i> | 837,930 | – |
| | 2,245,403,442 | 2,176,914,716 |

25.4 Analysis of maturity of refinance borrowings

| | 2018 LKR | 2017 LKR |
|---------------------|----------------------|----------------------|
| Due within one year | 985,193,182 | 742,386,052 |
| 1-5 years | 1,223,230,860 | 1,235,764,364 |
| After 5 years | 36,979,400 | 198,764,300 |
| | 2,245,403,442 | 2,176,914,716 |

25.5 Securities and terms

Interest rate ranging for above borrowings 0.5% to 15.12% per annum.

Bank has pledged from the lease portfolio sum of LKR 1,892,536,930.00 for the securitised borrowings. (2017 – LKR 2,014,701,610.00)

Year ended 31 December

26. Debt security issued

| | 2018 LKR | 2017 LKR |
|--------------|----------------------|----------------------|
| Debentures | 4,198,547,716 | 4,189,812,218 |
| Total | 4,198,547,716 | 4,189,812,218 |

26.1 Types of debentures (Fixed)

(i) Rated Guaranteed Redeemable Debentures of LKR 100.00 each – Guaranteed by Sampath Bank PLC. The debentures are quoted on the Colombo Stock Exchange. (Rated (SL)A+ (SO) with a Stable Outlook by ICRA Lanka Limited).

| Type | Interest payable frequency | Issue date | Maturity date | Annual effective rate (AER) % | Face value | Interest payable | Balance |
|------|----------------------------|------------------|------------------|-------------------------------|---------------|------------------|---------------|
| A | Semi-annually | 31 December 2015 | 31 December 2018 | 9.83 | 1,597,390,000 | 77,304,923 | 1,674,694,923 |
| B | Semi-annually | 31 December 2015 | 31 December 2020 | 10.25 | 402,610,000 | 20,295,956 | 422,905,956 |
| | | | | | 2,000,000,000 | 97,600,879 | 2,097,600,879 |

(ii) Rated Guaranteed Redeemable Debentures of LKR 100.00 each – Guaranteed by Seylan Bank PLC. The debentures are quoted on the Colombo Stock Exchange. (Rated (SL)A- (SO) with a Stable Outlook by ICRA Lanka Limited).

| Type | Interest payable frequency | Issue date | Maturity date | Annual effective rate (AER) % | Face value | Interest payable | Balance |
|------|----------------------------|------------------|------------------|-------------------------------|---------------|------------------|---------------|
| C | Semi-annually | 31 December 2015 | 31 December 2018 | 10.15 | 1,438,050,000 | 71,768,545 | 1,509,818,545 |
| D | Semi-annually | 31 December 2015 | 31 December 2020 | 10.57 | 561,950,000 | 29,178,292 | 591,128,292 |
| | | | | | 2,000,000,000 | 100,946,837 | 2,100,946,836 |
| | | | | | 4,000,000,000 | 198,547,716 | 4,198,547,716 |

27. Subordinated term debts

| | 2018 LKR | 2017 LKR |
|-------------------------|----------------------|----------------------|
| Subordinated term debts | 1,008,027,823 | 1,004,354,742 |
| Total | 1,008,027,823 | 1,004,354,742 |

27.1 Subordinated term debts – Details

| Investor | Tenor/Repayment | Interest rate | 2018 LKR | 2017 LKR |
|--------------------------------|-----------------------------------------|-------------------------------------------------------------|----------------------|----------------------|
| FMO | Repayment or conversion after 66 months | 6-month T-bill rate + 550 basis points Payable per annum | 706,706,095 | 707,197,511 |
| SBI-FMO | Repayment or conversion after 66 months | 6-month T-bill rate + 450 basis points Payable per annum | 316,696,269 | 317,031,638 |
| Less: Initial transaction cost | | | (15,374,541) | (19,874,408) |
| | | | 1,008,027,823 | 1,004,354,742 |

Year ended 31 December

28. Other liability

| | 2018 LKR | 2017 LKR |
|------------------------------------------------------------------|----------------------|----------------------|
| Defined benefit plan – Retiring gratuity obligations (Note 28.1) | 354,854,450 | 257,476,102 |
| Special purpose project funds | 407,765,490 | 432,773,270 |
| Accruals and other payables | 360,067,912 | 336,639,836 |
| Total | 1,122,687,852 | 1,026,889,208 |

28.1 Retirement benefit obligations**28.1.1 Defined benefit liability**

| | 2018 LKR | 2017 LKR |
|-----------------------------------------|-------------|-------------|
| Defined benefit liability (Note 28.1.2) | 354,854,450 | 257,476,102 |
| | 354,854,450 | 257,476,102 |

28.1.2 Changes in the defined benefit obligation are as follows:

| | 2018 LKR | 2017 LKR |
|----------------------------------------------------|--------------------|--------------------|
| Defined benefit obligation as of 1 January | 257,476,102 | 212,494,263 |
| Net benefit expense (Note 28.1.3) | 100,585,945 | 49,038,962 |
| Benefit paid | (3,207,597) | (4,057,124) |
| Defined benefit liability as of 31 December | 354,854,450 | 257,476,101 |

28.1.3 Net benefit expense

| | 2018 LKR | 2017 LKR |
|-------------------------------------------------------------|--------------------|-------------------|
| Interest cost | 28,359,486 | 25,362,255 |
| Current service cost | 26,231,153 | 26,561,782 |
| | 54,590,639 | 51,924,037 |
| Amounts recognised in the other comprehensive income | | |
| Actuarial (Gain)/Loss on obligations | 45,995,306 | (2,885,075) |
| Balance at the end of the year | 100,585,945 | 49,038,962 |

28.1.4 The principal financial assumptions used are as follows:

Messrs Piyal S Goonetilleke Actuaries, carried out an actuarial valuation of the defined benefit plan gratuity on 31 December 2018. Appropriate and compatible assumptions were used in determining the cost of retirement benefits. The principal assumptions used are as follows:

| | 2018 | 2017 |
|-----------------------------|----------|----------|
| Long term interest rate | 12.30% | 10.40% |
| Future salary increase rate | 11.30% | 9.40% |
| Retirement age | 55 years | 55 years |

Mortality – GA 1983 Mortality Table issued by the Institute of Actuaries London.

The average duration of the defined benefit plan obligation at the end of the reporting period is 10.5 years.

Year ended 31 December

28.2 Sensitivity analysis on discounting rate and salary increment rate to statement of financial position and comprehensive income

| Assumption | Rate change | 2018 | | 2017 | |
|-----------------------|-------------|-----------------------------------------------------------------|---------------------------------------------------|-----------------------------------------------------------------|---------------------------------------------------|
| | | Impact to financial position increment/(Reduction) of liability | Impact to comprehensive income charged/(Reversal) | Impact to financial position Increment/(Reduction) of liability | Impact to comprehensive income charged/(Reversal) |
| Discount rate | 1+ | (31,422,769) | (31,422,769) | (24,073,734) | (24,073,734) |
| Discount rate | 1- | 36,365,685 | 36,365,685 | 27,982,463 | 27,982,463 |
| Salary increment rate | 1+ | 35,249,002 | 35,249,002 | 29,084,484 | 29,084,484 |
| Salary increment rate | 1- | (31,042,941) | (31,042,941) | (25,363,729) | (25,363,729) |

28.3 The expected Benefit payout in the future years of Retirement Gratuity

| | 2018 LKR | 2017 LKR |
|-----------------------|-------------|-------------|
| Within next 12 months | 29,520,864 | 20,188,199 |
| Between 2 and 5 years | 209,523,632 | 142,334,381 |
| Beyond 5 years | 471,331,175 | 276,456,232 |

29. Stated capital

| | 2018 LKR | 2017 LKR |
|-----------------------------------------|----------------------|----------------------|
| Ordinary shares – Issued and fully paid | 5,921,538,126 | 5,758,689,211 |
| Total | 5,921,538,126 | 5,758,689,211 |

| Ordinary shares – Issued and fully paid | At the beginning of the year 1 January 2018 | Issued for script during the year | Redemptions/ transfers | At the end of the year 31 December 2018 |
|-----------------------------------------|---------------------------------------------|-----------------------------------|------------------------|-----------------------------------------|
| | Number | Number | Number | Number |
| Ordinary shares – Voting | 54,778,867 | 1,529,385 | – | 56,308,252 |
| | 54,778,867 | 1,529,385 | – | 56,308,252 |

| Ordinary share value – Voting | At the beginning of the year 1 January 2018 | Issued for cash during the year | Redemptions/ transfers | At the end of the year 31 December 2018 |
|-------------------------------|---------------------------------------------|---------------------------------|------------------------|-----------------------------------------|
| | LKR | LKR | LKR | LKR |
| Ordinary share value – Voting | 5,758,689,211 | 162,848,915 | – | 5,921,538,126 |
| | 5,758,689,211 | 162,848,915 | – | 5,921,538,126 |

30. Statutory reserve fund

| | 2018 LKR | 2017 LKR |
|----------------------------|--------------------|--------------------|
| Opening balance | 197,763,963 | 172,372,786 |
| Transfer during the period | 17,847,506 | 25,391,177 |
| Closing balance | 215,611,469 | 197,763,963 |

Year ended 31 December

31. Retained earnings

| | 2018 LKR | 2017 LKR |
|----------------------------------------------------|----------------------|----------------------|
| Opening balance | 1,340,503,862 | 1,249,742,153 |
| Impact of adoption of SLFRS 9 as at 1 January 2018 | (37,054,387) | – |
| Profit for the year | 323,833,499 | 509,900,786 |
| Transfers to other reserves | (17,847,506) | (25,391,177) |
| Scrip dividend | (191,726,035) | (262,498,600) |
| Cash dividend | (136,947,168) | (131,249,300) |
| Closing balance | 1,280,762,266 | 1,340,503,862 |
| Dividend per share | 5.8 | 7.7 |

32. Other reserves

| | Opening balance at 1 January 2018 LKR | Movement/ transfers LKR | Closing balance at 31 December 2018 LKR |
|----------------------------------|------------------------------------------------|-------------------------------|--------------------------------------------------|
| General reserve | 46,656,973 | – | 46,656,973 |
| FVOCI/available-for-sale reserve | (12,453,979) | (3,388,111) | (15,842,090) |
| Total | 34,202,994 | (3,388,111) | 30,814,883 |

| | Opening balance at 1 January 2017 LKR | Movement/ transfers LKR | Closing balance at 31 December 2017 LKR |
|----------------------------|------------------------------------------------|-------------------------------|--------------------------------------------------|
| General reserve | 46,656,973 | – | 46,656,973 |
| Available-for-sale reserve | (12,453,979) | – | (12,453,979) |
| Total | 34,202,994 | – | 34,202,994 |

33. Contingent liabilities and commitments

| | 2018 LKR | 2017 LKR |
|------------------------|--------------------|--------------------|
| 33.1 Guarantees | 182,986,032 | 166,260,031 |
| Total | 182,986,032 | 166,260,031 |

33.2 Litigation against the Bank

Litigation is a common occurrence in the banking industry due to the nature of the business undertaken. The Bank has formal controls and policies for managing legal claims. Once professional advice has been obtained and the amount of loss reasonably estimated, the Bank makes adjustments to account for any adverse effects which the claims may have on its financial standing. At the year end, the Bank had several unresolved legal claims. The Bank is of the opinion that litigation which is currently pending will not have a material impact on the reported financial results of the Bank.

Following cases are filed against the Bank:

1. L/17/11 – DC Kesbewa

In the above case the Bank has been made the second defendant to a land case claiming a sum of LKR 7,000,000.00 against a property mortgage. The case is on trial stage. Registered attorney is Mr Augustus Jayarathne.

2. SPL 252/11 – DC Elpitiya

The plaintiff of this case is Diyakithulkanda Society and defendants are Kotmale Milk Food (Pvt) Ltd and SANASA Development Bank PLC. Claiming amount is sum of LKR 1,000,000.00 case filed against a bank Guarantee. The case is on trial stage. Registered attorney is Mr N Halpandeniya.

3. DSP 178/09 – DC Kandy

Above case filed against the Bank challenging the legality of repossession of leased vehicle and plaint value is sum of LKR 3.5 Mn. Presently the case is on trial stage. Registered attorney is Mr A M Ganganatha and Counsel is Mr Samantha Ratwatte (Precedent's Counsel).

4. DMR/496/15 – DC Colombo

The case has been filed against the Bank challenging the legality of a writ execution and claiming that the Bank has unduly enriched. The plaint value is LKR 6,000,000.00. Presently the case is on trial stage. Registered attorney is Mr Augustus Jayarathne.

5. MB 1935 – DC Matale

The case has been filed by a group of people who occupy the mortgage property claiming possession of the same. Outstanding value of the mortgage bond is LKR 1,331,471.60. Case is to consider survey plan. Registered attorney is Mr S M M Koswatta.

6. 6495/SPL – DC Colombo

This is a special case filed against the Bank its Board of Directors, and the case has been dismissed by the Civil Appeal High Court of Western Province. Said Order to be pronounced at the District Court. The Registered attorney Samarathne Associate.

7. 207/CL – DC Kuliypitiya

Assets of the guarantors in Case No. 1827/M have been seized by the fiscal as per the judgement of that case. The Petitioner has filed this claim case claiming rights for the seized assets. Presently the case is in trial stage. The Registered attorney is Mr Supun Adikari.

8. 6940/P – DC Kurunegala

A partition action has been filed where a portion of the subject land has been mortgage to the Bank. Presently case is in the stage of filling Statement of claim and consideration of survey plan. Registered Attorney is Mr G B Senanayake.

9. 13/17/CL – DC Badulla (Leasing)

Assets of the guarantors in Case No. 1805/M have been seized by the fiscal as per the judgement of that case. The Petitioner has filed this claim case claiming rights for the seized assets. Presently the objections filed by the Bank. The Registered attorney is Mrs Niranjala Rathnayake.

10. 551/CL, 552/CL and 553/CL – DC Avissawella

Assets of the guarantors in Case No. 27944/M have been seized by the fiscal as per the judgement of that case. The petitioner has filed three claim cases claiming rights for the seized assets. Presently settlements entered in the cases. The Registered attorney is Ms W M J C Wijemanna.

11. DMR/4015/17 – DC Colombo

The Bank rejected to renew the service contract of Mr I M Aruna Dayanatha as Head of HR. Mr Dayanatha filed an action against the Bank and the members of BHRRC claiming damages of LKR 500,000,000.00 for reputational loss suffered from non-renewal of his service contract. Presently the case fixed for amended plaint. The Registered attorney is Mrs Bushra Hashim.

12. 218/L – DC Wariyapola

Plaintiff mortgaged the subject property to the Bank and filed land ejection case to eject licensee occupying the property. The Bank is 2nd defendant. Case is coming up to file answer. The Registered attorney is Mrs Jenat Jayawardana.

13. M/10238 – DC Galle

An injunction order obtained against auction of the property in Case No. MB/2808 filed in DC Galle. Presently the case fixed for objection. The Registered attorney is Mr M S Dahanayake.

14. WP/HCCA/COL/139/2018

The initial case related to a mortgage bond action where the order granted favouring the Bank, and defendant appealed to High Court under Case No. WP/HCCA/COL 237/2010 (F) against the order and such appeal dismissed without costs. The defendant filed present action praying leave to appeal against the previous order. Presently the case fixed for support. The Registered attorney Mr Augustus Jayarathne.

15. WP/HCCA/COL/272/15 (F)

An appeal case filed against the order of the preliminary case bearing No. DMB/124/09 of District Court Colombo. Presently the case is fixed for argument. The Registered attorney Mr Saman Suraweera.

34. Events occurring after the reporting date

There are no material events after the reporting date that require adjustments to or disclosure in the Financial Statements.

35. Related party disclosure

The Bank carries out transaction in the ordinary course of business with the parties who are defined as related parties in the Sri Lanka Accounting Standard – LKAS 24 (“Related Party Disclosures”), the details of which are reported below:

35.1 Transactions with other related parties

According to the LKAS 24, FMO consider as a related party (Significant Investor) and all transaction with FMO are given below.

| | 2018 LKR | 2017 LKR |
|---------------------------|-------------|-------------|
| Interest repayment | 240,127,258 | 40,788,616 |
| Reimbursement of expenses | 2,465,459 | 25,054,634 |

35.2 Transactions with key management personnel

Key Management Personnel include: the Chairman, the Board of Directors, and Chief Executive Officer, Chief Operating Officer of the Bank. Transactions with close family members of Key Management Personnel are also taken into account in the transactions with Key Management Personnel. The same term, including interest/commission rates and security, as for comparable transaction with person of a similar standing or, where applicable, with the employees. The transaction did not involve more than the normal risk of repayment or present other unfavourable features.

35.2.1 Key management personnel compensation

| | 2018 LKR | 2017 LKR |
|------------------------------|-------------|-------------|
| Short term employee benefits | 33,113,000 | 31,794,000 |
| Post employment benefits | 2,080,800 | 2,346,000 |

35.2.2 Other transactions with key management personnel – Balance outstanding

| | 2018 LKR | 2017 LKR |
|----------------------------------|------------------|------------------|
| Balance as at 1 January | 2,352,976 | 2,620,771 |
| Grantings | – | – |
| Repayments | (323,793) | (267,795) |
| Balance as at 31 December | 2,029,183 | 2,352,976 |
| Interest income | 300,885 | 328,950 |

35.2.3 Deposits and Investment from key management personnel – Balance outstanding

| | 2018 LKR | 2017 LKR |
|--------------------------------------------------|-------------|-------------|
| Deposits accepted and reviewed during the period | 2,982,512 | 3,630,269 |
| Balance as at 31 December | 163,274 | 1,271,965 |
| Interest expenses | 10,138 | 10,668 |

35.2.4 Other payment to key management personnel

| | 2018 LKR | 2017 LKR |
|---------------|-------------|-------------|
| Cash dividend | 157,494 | 4,343 |

35.2.5 Share purchase

| | 2018 Nos. | 2017 Nos. |
|--------|--------------|--------------|
| Shares | – | 73,062 |

35.2.6 Term and conditions of transaction with related parties

All related party transactions are carried out in the normal course of business and transacted at normal business terms. Transaction from related parties are made on terms equivalent to those that prevail in arm's length transaction and comparable with those that would have been charged from unrelated companies. All related party outstanding balances at the year-end are secured and are to be settled in cash.

36. Assets pledged

Bank has pledged from the lease portfolios sum of LKR 1,892,536,929.00 (2017 – LKR 2,014,701,610.00) for the securitised borrowings.

37. Analysis of financial instruments by measurement basis

| As at 31 December 2018 | Amortised cost LKR | FVPL LKR | FVOCI LKR | Total LKR | |
|----------------------------------------------------------------------------|-----------------------|--------------------|-------------------|-----------------------|-----------------------|
| Financial assets | | | | | |
| Cash and cash equivalents | 4,171,938,630 | – | – | 4,171,938,630 | |
| Placements with banks | 9,528,425,565 | – | – | 9,528,425,565 | |
| Financial assets at fair value through profit or loss | – | 146,103,330 | – | 146,103,330 | |
| Financial assets at amortised cost: | | | | | |
| – Loans and receivables to other customers | 77,507,021,162 | – | – | 77,507,021,162 | |
| – Debt and other instruments | 3,405,600,286 | – | – | 3,405,600,286 | |
| Financial assets measured at fair value through other comprehensive income | – | – | 60,148,048 | 60,148,048 | |
| Total financial assets | 94,612,985,642 | 146,103,330 | 60,148,048 | 94,819,237,021 | |
| Financial liabilities | | | | | |
| Due to other customers | 67,474,821,535 | – | – | 67,474,821,535 | |
| Other borrowings | 15,420,967,962 | – | – | 15,420,967,962 | |
| Debt Securities issued | 4,198,547,716 | – | – | 4,198,547,716 | |
| Subordinated term debts | 1,008,027,823 | – | – | 1,008,027,823 | |
| Total financial liabilities | 88,102,365,036 | – | – | 88,102,365,036 | |
| As at 31 December 2017 | | | | | |
| | FVTPL LKR | HTM LKR | AFS LKR | Amortised cost LKR | Total LKR |
| Financial assets | | | | | |
| Cash and cash equivalents | – | – | – | 1,190,389,606 | 1,190,389,606 |
| Placements with banks | – | – | – | 6,014,703,836 | 6,014,703,836 |
| Financial assets at fair value through profit or loss | 4,473,805,573 | – | – | – | 4,473,805,573 |
| Financial investments – Available for sale | – | – | 63,536,159 | – | 63,536,159 |
| Financial investments – Held to maturity | – | 599,551,021 | – | – | 599,551,021 |
| Loans and receivables to other customers | – | – | – | 66,687,415,593 | 66,687,415,593 |
| Other financial asset classified under loans and receivable | – | – | – | 1,479,949,628 | 1,479,949,628 |
| Total financial assets | 4,473,805,573 | 599,551,021 | 63,536,159 | 75,372,458,663 | 80,509,351,416 |
| Financial liabilities | | | | | |
| Due to other customers | – | – | – | 59,904,734,365 | 59,904,734,365 |
| Other borrowings | – | – | – | 8,827,609,604 | 8,827,609,604 |
| Debt securities issued | – | – | – | 4,189,812,218 | 4,189,812,218 |
| Subordinated term debts | – | – | – | 1,004,354,742 | 1,004,354,742 |
| Total financial liabilities | – | – | – | 73,926,510,929 | 73,926,510,929 |

38. Fair value of financial instruments

38.1 Financial instruments recorded at fair value

The following is a description of how fair values are determined for financial instrument that are record at fair value using valuation techniques. These incorporate the Bank's estimate of assumption that a market participant would make when valuing the instrument.

Fair value through OCI/Financial investment – Available for sale

Fair value through OCI valued using valuation techniques or pricing models primary consist of unquoted equity securities.

Fair value through profit and loss/Financial investment – Held for trading

Quoted equities and Sri Lanka Government Securities – Treasury Bills and Bonds included in financial assets – Held for trading are valued using market price.

38.2 Determination of fair value and fair value hierarchy

The Bank uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities.

Level 2: Other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly.

Level 3: Techniques which use inputs that have a significant effect on the recorded fair value that are not based on observable market data.

The following table shows an analysis of financial instruments recorded at fair value by level of fair value hierarchy:

38.2.1

| Financial assets | As at 31 December 2018 | | | |
|-----------------------------------------------------------|------------------------|----------------|----------------|---------------|
| | Level 1 LKR | Level 2 LKR | Level 3 LKR | Total LKR |
| Financial assets fair value through profit or loss | | | | |
| Quoted equities | - | - | - | - |
| Sri Lanka Government Securities – Treasury bond | - | - | - | - |
| Unit trusts | 146,103,330 | - | - | 146,103,330 |
| Fair value through OCI | - | - | 60,148,048 | 60,148,048 |
| Unquoted equities | - | - | - | - |
| | 146,103,330 | - | 60,148,048 | 206,251,378 |
| Financial assets | | | | |
| | | | | |
| As at 31 December 2017 | | | | |
| | | | | |
| Financial assets fair value through profit or loss | | | | |
| Quoted equities | 20,567,010 | - | - | 20,567,010 |
| Sri Lanka Government Securities – Treasury bond | - | 337,940,600 | - | 337,940,600 |
| Unit trusts | 4,115,297,963 | - | - | 4,115,297,963 |
| Financial investments – Available for sale: | | | | |
| | | | | |
| Unquoted equities | - | - | 63,536,159 | 63,536,159 |
| | 4,135,864,973 | 337,940,600 | 63,536,159 | 4,537,341,732 |

The following table shows the total gains and losses recognised in profit or loss during the year relating to assets and liabilities held at the year end:

Net trading income

| Financial assets | 2018 LKR | 2017 LKR |
|--------------------------------------------------------------|--------------------|--------------------|
| Financial assets at fair value through profit or loss | | |
| Sri Lanka Government Securities – Treasury bond | (942,414) | 24,727,750 |
| Unit trust | 281,114,474 | 187,031,644 |
| | 280,172,060 | 211,759,394 |

38.3 Fair value of financial assets and liabilities not carried at fair value

Setout below is a comparison, by class, of the carrying amounts and fair values of the Bank's financial instruments that are not carried at fair value in the Financial Statements. This table does not include the fair values of non-financial assets and non-financial liabilities.

| As at 31 December 2018 | Level | Carrying value LKR | Fair value LKR |
|--------------------------------------------|-------|-----------------------|-----------------------|
| Financial assets | | | |
| Cash and cash equivalents | Note* | 4,171,938,630 | 4,171,938,630 |
| Placements with banks | Note* | 9,528,425,565 | 9,528,425,565 |
| Financial investments – Held to maturity | 1, 2 | – | – |
| Financial assets at amortised cost: | | | |
| – Loans and receivables to other customers | 2 | 77,507,021,162 | 77,781,165,229 |
| – Debt and other instruments | Note* | 3,405,600,286 | 3,405,600,286 |
| Total financial assets | | 94,612,985,642 | 94,887,129,710 |
| Financial liabilities | | | |
| Due to other customers | 2 | 67,474,821,535 | 57,889,168,348 |
| Other borrowings | 2 | 15,420,967,962 | 15,418,148,997 |
| Debt securities issued | 2 | 4,198,547,716 | 4,198,547,716 |
| Subordinated term debts | 2 | 1,008,027,823 | 1,008,027,823 |
| Total financial liabilities | | 88,102,365,036 | 78,513,892,884 |

| As at 31 December 2017 | | Carrying value LKR | Fair value LKR |
|-------------------------------------------------------------|-------|-----------------------|-----------------------|
| Financial assets | | | |
| Cash and cash equivalents | Note* | 1,190,389,606 | 1,190,389,606 |
| Placements with banks | Note* | 6,014,703,836 | 6,014,703,836 |
| Financial investments – Held to maturity | 1,2 | 599,551,021 | 599,551,021 |
| Loans and receivables to other customers | 2 | 66,687,415,593 | 73,537,376,761 |
| Other financial asset classified under loans and receivable | Note* | 1,479,949,628 | 1,479,949,628 |
| Total financial assets | | 75,972,009,684 | 82,821,970,852 |
| Financial liabilities | | | |
| Due to other customers | 2 | 59,904,734,365 | 58,697,767,996 |
| Other borrowings | 2 | 8,827,609,604 | 8,838,725,237 |
| Debt securities issued | 2 | 4,189,812,218 | 4,189,812,218 |
| Subordinated term debts | 2 | 1,004,354,742 | 1,004,354,742 |
| Total financial liabilities | | 73,926,510,929 | 72,730,660,193 |

Note*

Fair value of financial assets and liabilities not carried at fair value

The following describes the methodologies and assumptions used to determine fair values for those financial instruments which are not already recorded at fair value in the Financial Statements:

Assets for which fair value approximates carrying value

For financial assets and financial liabilities that have a short-term maturity (less than a year) it is assumed that the carrying amounts approximate their fair value. This assumption is also applied to demand deposits and savings accounts without a specific maturity. Loans and advances to customers with a variable rate are also considered to be carried at fair value.

Fixed rate financial instruments

The fair value of fixed rate financial assets and liabilities carried at amortised cost are estimated by comparing market interest rates when they were first recognised with current market rates for similar financial instruments. The estimated fair value of fixed interest bearing deposits is based on discounted cash flows using prevailing interest rates of the Bank.

39. Segment reporting

| | 31 December 2018 | | | | |
|--------------------------------------------------------------------------|-----------------------|----------------------|-----------------------|----------------------|-----------------------|
| | Banking LKR | Leasing LKR | Treasury LKR | Pawning LKR | Total LKR |
| Interest income | 10,947,252,698 | 827,449,414 | 1,161,471,770 | 180,607,695 | 13,116,781,577 |
| Interest expenses | (6,611,642,530) | (474,369,619) | (1,221,112,089) | (116,633,491) | (8,423,757,729) |
| Net interest income | 4,335,610,168 | 353,079,795 | (59,640,319) | 63,974,204 | 4,693,023,848 |
| Fee and commission income | 194,148,717 | 32,618,933 | – | – | 226,767,650 |
| Fee and commission expenses | (4,102,534) | (294,347) | – | – | (4,396,881) |
| Net fee and commission income | 190,046,183 | 32,324,586 | – | – | 222,370,769 |
| Net loss from financial instruments at fair value through profit or loss | – | – | 280,172,060 | – | 280,172,060 |
| Other operating income (net) | 20,334,514 | – | 476,587 | – | 20,811,101 |
| Total operating income | 4,545,990,865 | 385,404,381 | 221,008,326 | 63,974,204 | 5,216,377,778 |
| Impairment for loans and other losses | (470,940,030) | (51,990,820) | (6,127,309) | 3,214,279 | (525,843,880) |
| Net operating income | 4,075,050,835 | 333,413,561 | 214,881,017 | 67,188,484 | 4,690,533,898 |
| Depreciation and amortisation expenses | (205,765,548) | (14,763,188) | (101,863) | (3,629,832) | (224,260,432) |
| Segment result | 3,869,285,287 | 318,650,373 | 214,779,154 | 63,558,651 | 4,466,273,467 |
| Un-allocated expenses | | | | | (3,353,205,201) |
| Value Added Tax (VAT) on financial services | | | | | (362,940,818) |
| Nation Building Tax (NBT) on financial services | | | | | (52,702,722) |
| Debt repayment levy | | | | | (53,282,253) |
| Profit before tax | | | | | 644,142,476 |
| Tax expenses | | | | | (287,192,354) |
| Profit for the year | | | | | 356,950,122 |
| Other comprehensive income | | | | | |
| Other comprehensive income for the year net of tax | | | | | (36,504,731) |
| Total comprehensive income for the year | | | | | 320,445,391 |
| Segment assets | 71,147,289,913 | 5,104,648,758 | 13,140,277,228 | 1,255,082,491 | 90,647,298,390 |
| Un-allocated assets | – | – | – | – | 6,170,468,795 |
| Total assets | 71,147,289,913 | 5,104,648,758 | 13,140,277,228 | 1,255,082,491 | 96,817,767,185 |
| Segment liabilities | 70,144,010,272 | 5,032,665,831 | 12,954,980,323 | 1,237,384,014 | 89,369,040,440 |
| Total equity | – | – | – | – | 7,448,726,745 |
| Total liabilities | 70,144,010,272 | 5,032,665,831 | 12,954,980,323 | 1,237,384,014 | 96,817,767,185 |
| Addition to non-current assets | 199,134,182 | 14,287,411 | – | 3,512,853 | 216,934,545 |

| | 31 December 2017 | | | | |
|--------------------------------------------------------------------------|-----------------------|----------------------|-----------------------|--------------------|-----------------------|
| | Banking LKR | Leasing LKR | Treasury LKR | Pawning LKR | Total LKR |
| Interest income | 8,694,173,937 | 721,645,748 | 1,290,243,796 | 123,269,591 | 10,829,333,073 |
| Interest expenses | (5,391,440,541) | (371,915,259) | (1,105,488,235) | (72,996,465) | (6,941,840,502) |
| Net interest income | 3,302,733,396 | 349,730,489 | 184,755,561 | 50,273,126 | 3,887,492,571 |
| Fee and commission income | 235,993,758 | 42,775,806 | – | – | 278,769,565 |
| Fee and commission expenses | (3,284,524) | (226,575) | – | – | (3,511,099) |
| Net fee and commission income | 232,709,233 | 42,549,231 | – | – | 275,258,465 |
| Net loss from financial instruments at fair value through profit or loss | – | – | 211,759,394 | – | 211,759,394 |
| Other operating income (net) | 43,915,955 | – | 6,929,443 | – | 50,845,398 |
| Total operating income | 3,579,358,584 | 392,279,720 | 403,444,398 | 50,273,126 | 4,425,355,827 |
| Impairment for loans and other losses | (299,934,014) | 11,201,293 | – | (4,804,188) | (293,536,909) |
| Net operating income | 3,279,424,570 | 403,481,013 | 403,444,398 | 45,468,938 | 4,131,818,919 |
| Depreciation and amortisation expenses | (176,533,215) | (12,824,707) | (126,953) | (2,092,098) | (191,576,973) |
| Segment result | 3,102,891,355 | 390,656,306 | 403,317,444 | 43,376,840 | 3,940,241,946 |
| Un-allocated expenses | | | | | (2,838,197,046) |
| Value Added Tax (VAT) on financial services | | | | | (300,961,853) |
| Nation building tax (NBT) on financial services | | | | | (48,481,937) |
| Debt repayment levy | | | | | – |
| Profit before tax | | | | | 752,601,110 |
| Tax expenses | | | | | (244,777,577) |
| Profit for the year | | | | | 507,823,534 |
| Other comprehensive income | | | | | |
| Other comprehensive income for the year net of tax | | | | | 2,077,254 |
| Total comprehensive income for the year | | | | | 509,900,788 |
| Segment assets | 61,603,758,587 | 4,249,583,702 | 12,631,546,216 | 834,073,305 | 79,318,961,810 |
| Un-allocated assets | – | – | – | – | 3,055,751,492 |
| Total assets | 61,603,758,587 | 4,249,583,702 | 12,631,546,216 | 834,073,305 | 82,374,713,302 |
| Segment liabilities | 58,283,225,521 | 4,020,524,899 | 11,950,687,323 | 789,115,528 | 75,043,553,271 |
| Total equity | – | – | – | – | 7,331,160,031 |
| Total liabilities | 58,283,225,521 | 4,020,524,899 | 11,950,687,323 | 789,115,528 | 82,374,713,302 |
| Addition to non-current assets | 251,532,033 | 18,273,188 | – | 2,980,909 | 272,786,130 |

40. Maturity analysis of assets and liabilities-Bank

The table below shows an analysis of assets and liabilities analysed according to when they are expected to be recovered or settled:

| | 31 December 2018 | | | 31 December 2017 | | |
|----------------------------------------------------------------------------|----------------------------|---------------------------|-----------------------|----------------------------|---------------------------|-----------------------|
| | Within 12 Months LKR | After 12 Months LKR | Total LKR | Within 12 Months LKR | After 12 Months LKR | Total LKR |
| Assets | | | | | | |
| Cash and cash equivalents | 4,171,938,629 | – | 4,171,938,629 | 1,190,389,606 | – | 1,190,389,606 |
| Placements with banks | 9,528,425,565 | – | 9,528,425,565 | 6,014,703,836 | – | 6,014,703,836 |
| Financial assets fair value through profit or loss | 146,103,330 | – | 146,103,330 | 4,473,805,573 | – | 4,473,805,573 |
| Loans and receivables to other customers | 17,213,381,317 | 60,293,639,845 | 77,507,021,162 | 14,188,294,779 | 52,499,120,815 | 66,687,415,593 |
| Debt and other instruments | 3,316,920,287 | 88,680,000 | 3,405,600,287 | – | – | – |
| Other financial asset classified under loans and receivable | – | – | – | 1,316,269,628 | 163,680,000 | 1,479,949,628 |
| Financial assets measured at fair value through other comprehensive income | – | 60,148,048 | 60,148,048 | – | – | – |
| Financial investments – Available for sale | – | – | – | – | 63,536,159 | 63,536,159 |
| Financial investments – Held to maturity | – | – | – | – | 599,551,021 | 599,551,021 |
| Asset classified as held for sale | – | – | – | 37,175,411 | – | 37,175,411 |
| Property, plant and equipment | – | 704,738,491 | 704,738,491 | – | 726,472,630 | 726,472,630 |
| Investment properties | – | 22,334,630 | 22,334,630 | – | 23,390,660 | 23,390,660 |
| Intangible assets | – | 3,727,725 | 3,727,725 | – | 8,148,340 | 8,148,340 |
| Deferred tax assets | – | 69,414,926 | 69,414,926 | – | – | – |
| Other assets | 1,198,314,392 | – | 1,198,314,392 | 1,070,174,846 | – | 1,070,174,846 |
| Total assets | 35,575,083,520 | 61,242,683,665 | 96,817,767,185 | 28,290,813,678 | 54,083,899,624 | 82,374,713,303 |
| Liabilities | | | | | | |
| Due to other customers | 47,596,788,688 | 19,878,032,846 | 67,474,821,534 | 43,298,550,760 | 16,606,183,605 | 59,904,734,365 |
| Other borrowings | 6,221,139,240 | 9,199,828,723 | 15,420,967,963 | 3,333,255,454 | 5,494,354,151 | 8,827,609,604 |
| Debt securities issued | 3,233,987,716 | 964,560,000 | 4,198,547,716 | 198,547,716 | 3,991,264,502 | 4,189,812,218 |
| Subordinated term debts | 15,058,060 | 992,969,761 | 1,008,027,821 | 30,652,824 | 973,701,918 | 1,004,354,741 |
| Current tax liabilities | 143,987,553 | – | 143,987,553 | 32,152,744 | – | 32,152,744 |
| Deferred tax liabilities | – | – | – | – | 58,000,391 | 58,000,391 |
| Other liabilities | 767,833,402 | 354,854,450 | 1,122,687,852 | 769,413,106 | 257,476,102 | 1,026,889,208 |
| Total liabilities | 57,978,794,659 | 31,390,245,780 | 89,369,040,439 | 47,662,572,603 | 27,380,980,669 | 75,043,553,272 |
| Net assets/(liability) | (22,403,711,138) | 29,852,437,885 | 7,448,726,746 | (19,371,758,925) | 26,702,918,954 | 7,331,160,031 |

41. Risk management

41.1 Introduction

Risk is inherent in the Bank's activities but is managed through a process of ongoing identification, measurement and monitoring, subject to risk limits and other controls. This process of risk management is critical to the Bank's continuing profitability and each individual within the Bank is accountable for the risk exposures relating to his or her responsibilities. The Bank is exposed to credit risk, liquidity risk and market risk and operational risk.

The independent risk control process does include business risks such as changes in the environment, technology and industry. The bank's policy is to monitor those business risks through the Bank's strategic planning process.

Risk management structure

The Board of Directors is responsible for the overall risk management approach and for approving the risk management strategies and principles.

The Board has appointed the Board Subcommittee which has the responsibility to monitor the overall risk process within the Bank.

The Risk Committee has the overall responsibility for the development of the risk strategy and implementing principles, frameworks, policies and limits. The Risk Committee is responsible for managing risk decisions and monitoring risk levels and reports on a quarterly basis.

The Risk Management Unit is responsible for implementing and maintaining risk related procedures to ensure an independent control process is maintained. The unit works closely with the Risk Committee to ensure that procedures are compliant with the overall framework.

The Risk management Unit is responsible for monitoring compliance with risk principles, policies and limits across the Bank. This Unit responsible for the independent control of risks, including monitoring the risk of exposures against limits and the assessment of risks of new products and structured transactions. This unit also ensures the complete capture of the risks in risk measurement and reporting systems. Exceptions are reported on a periodically, where necessary, to the Risk Committee and the relevant actions are taken to address exceptions and any areas of weakness.

Bank treasury is responsible for managing the bank's assets and liabilities and the overall financial structure.

It is also primarily responsible for the funding and liquidity risks of the Bank.

The bank's policy is that risk management processes throughout the Bank are audited annually by the internal audit function, which examines both the adequacy of the procedures and the Bank's compliance with the procedures. Internal audit discusses the results of all assessments with management and reports its findings and recommendations to the Audit Committee.

Risk measurement and reporting systems

Monitoring and controlling risks is primarily performed based on limits established by the Bank. These limits reflect the business strategy and market environment of the Bank as well as the level of risk that the Bank is willing to accept, with additional emphasis on selected industries. In addition, the Bank's policy is to measure and monitor the overall risk bearing capacity in relation to the aggregate risk exposure across all risk types and activities.

Information compiled from all the businesses is examined and processed in order to analyse, control and identify risks on a timely basis. This information is presented and explained to the Board of Directors, the Risk Committee and the head of each business division. The report includes aggregate credit exposure, liquidity ratios and risk profile changes. On a monthly basis, detailed reporting of industry, customer and geographic risks takes place. Senior Management assesses the appropriateness of the allowance for credit losses on a monthly basis. The Board Subcommittee receives a comprehensive risk report once a quarter which is designed to provide all the necessary information to assess and conclude on the risks of the Bank.

For all levels throughout the Bank, specifically tailored risk reports are prepared and distributed in order to ensure that all business divisions have access to extensive, necessary and up to date information. A daily briefing is given to the General Manager, Chief Executive Officer and all other relevant members of the Bank on the utilisation of market limits, proprietary investments and liquidity and plus any other risk developments.

Risk mitigation

As part of its overall risk Management, the Bank uses several strategies and other instruments to manage exposures resulting from changes in interest rates, foreign currencies, equity risks, credit risks and exposures arising from forecast transactions. In accordance with the Bank’s policy, the risk profile of the Bank is assessed by the appropriate level of seniority within the Bank. The Bank actively uses collateral to reduce its credit risks.

Excessive risk concentration

Concentrations arise when a number of counterparties are engaged in similar business activities, or activities in the same geographical region, or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. Concentrations indicate the relative sensitivity of the Bank’s performance to developments affecting a particular industry or geographical location.

In order to avoid excessive concentrations of risk, the Bank’s policies and procedures include specific guidelines to focus on maintaining a diversified portfolio. Identified concentrations of credit risks are controlled and managed accordingly.

41.2 Credit risk

Credit risk is the risk that the Bank will incur a loss because its customers or counterparties fail to discharge their contractual obligations. The Bank manages and controls credit risk by setting limits on the amount of risk it is willing to accept for individual counterparties and for geographical and industry concentrations, and by monitoring exposures in relation to such limits.

The Bank has established a credit quality review process to provide early identification of possible changes in the creditworthiness of counterparties, including regular collateral revisions. Counterparty limits are established by the use of a credit risk evaluation system, which assigns each counterparty a risk. The credit quality review process aims to allow the Bank to assess the potential losses a result of the risks to which it is exposed and take corrective action.

Credit-related commitments risks

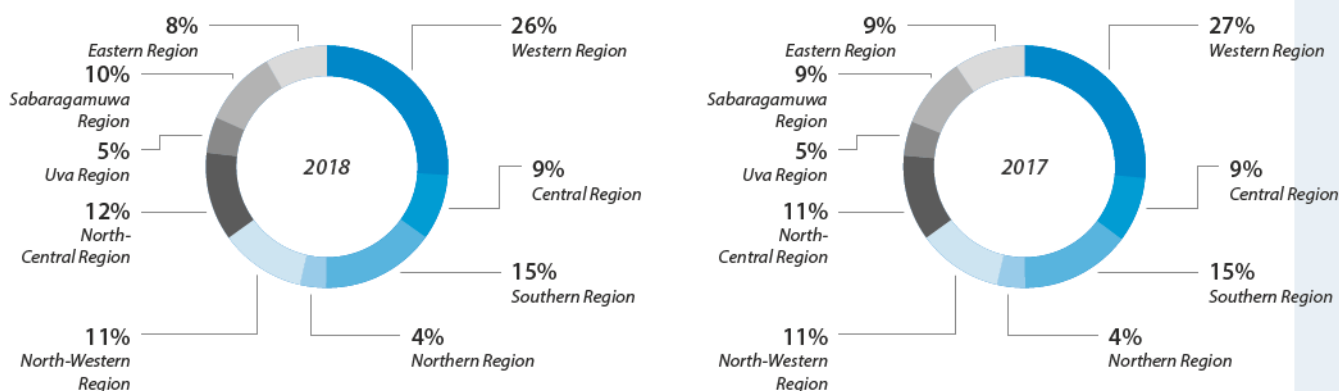
The Bank makes available to its customers guarantees which may require that the Bank makes payments on their behalf and enters into commitments to extend credit lines to secure their liquidity needs. Such commitments expose the Bank to similar risks to loans and are mitigated by the same control processes and policies.

Risk concentrations: maximum exposure to credit risk without taking account of any collateral and other credit enhancements.

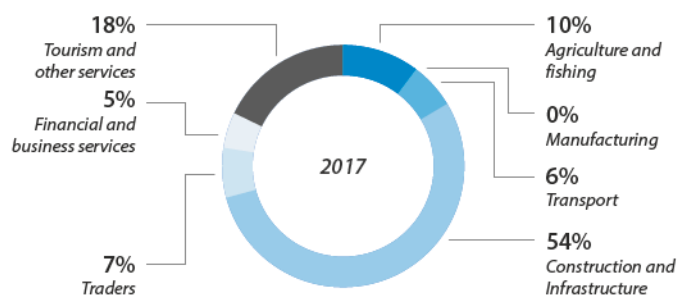
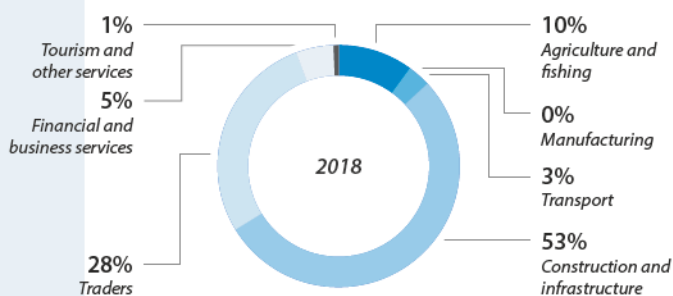
The bank’s concentrations of risk are managed by client/counterparty, by geographical region and by industry sector. The maximum credit exposure to any client or counterparty as of 31 December 2018 was LKR 330 Mn.

The following table shows the maximum exposure to credit risk for the components of the Statement of Financial Position, by geography of counterparty and by industry before the effect of mitigation through the use of master netting and collateral agreements. Where financial instruments are recorded at fair value, the amounts shown represent the current credit risk exposure but not the maximum risk exposure that could arise in the future as a result of changes in values.

Geographical Analysis



Industry analysis



Collateral and other credit enhancements

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty.

Guidelines are implemented regarding the acceptability of types of collateral and valuation parameters.

The main types of collateral obtained are as follows:

- Cash or securities
- Real estate properties
- Mortgages over residential properties
- Movable assets – Motor vehicle
- Gold

The Bank also obtains guarantees from parent companies for loans to their subsidiaries.

Management monitors the market value of collateral, requests additional collateral in accordance with the Underlying agreement and monitors the market value of collateral obtained during its review of the adequacy of the allowance for impairment losses.

It is the Bank’s policy to dispose of repossessed properties in an orderly fashion. The proceeds are used to reduce or repay the outstanding claim. In general, the Bank does not occupy repossessed properties for business use.

Maximum exposure credit risk by class of financial assets

| | 31 December 2018 | | 31 December 2017 | |
|--------------------------------------------------------------|-------------------------------------|-----------------------|-------------------------------------|-----------------------|
| | Maximum exposure to credit risk LKR | Net exposure LKR | Maximum exposure to credit risk LKR | Net exposure LKR |
| Cash and cash equivalents | 4,171,938,630 | 4,171,938,630 | 1,190,389,606 | 1,190,389,606 |
| Placements with banks | 9,528,425,565 | 9,528,425,565 | 6,014,703,836 | 6,014,703,836 |
| Financial assets fair value through profit or loss | 146,103,330 | 146,103,330 | 4,473,805,573 | 4,473,805,573 |
| Other financial asset classified under loans and receivables | - | - | 1,479,949,628 | 764,791,015 |
| Financial assets at amortised cost: | | | | |
| – loans and receivables to other customers | 79,482,459,527 | 65,213,196,435 | 68,104,871,364 | 49,479,935,628 |
| – debt and other instruments | 3,405,600,286 | 471,378,656 | - | - |
| Financial investments Held to maturity | - | - | 599,551,021 | 599,551,021 |
| Total | 96,734,527,338 | 79,531,042,616 | 81,863,271,028 | 62,523,176,679 |

Credit quality by class of financial assets

| 31 December 2018 | Neither past due nor impaired LKR | Pass due but not impaired LKR | Individually impaired LKR | Total LKR | |
|---------------------------------------------------------------|--------------------------------------|----------------------------------|------------------------------|--------------------------|----------------|
| Cash and cash equivalents | 4,171,938,630 | – | – | 4,171,938,630 | |
| Placements with banks | 9,528,425,565 | – | – | 9,528,425,565 | |
| Financial assets fair value through profit or loss | 146,103,330 | – | – | 146,103,330 | |
| Financial assets at amortised cost: | | | | | |
| – loans and receivables to other customers | 64,662,927,979 | 13,673,100,463 | 1,146,431,087 | 79,482,459,528 | |
| – debt and other instruments | 3,405,600,287 | – | – | 3,405,600,287 | |
| Total | 81,914,995,791 | 13,673,100,463 | 1,146,431,087 | 96,734,527,340 | |
| 31 December 2017 | Neither past due nor impaired LKR | Pass due but not impaired LKR | Individually impaired LKR | Total LKR | |
| Cash and cash equivalents | 1,190,389,606 | – | – | 1,190,389,606 | |
| Placements with banks | 6,014,703,836 | – | – | 6,014,703,836 | |
| Financial assets fair value through profit or loss | 4,473,805,573 | – | – | 4,473,805,573 | |
| Other financial asset classified under loans and receivables | 1,479,949,628 | – | – | 1,479,949,628 | |
| Loans and receivables to other customers (without impairment) | 56,734,234,623 | 10,873,357,267 | 497,279,475 | 68,104,871,364 | |
| Financial investments available for sale | 63,536,159 | – | – | 63,536,159 | |
| Financial investments held to maturity | 599,551,021 | – | – | 599,551,021 | |
| Total | 70,556,170,446 | 10,873,357,267 | 497,279,475 | 81,926,807,187 | |
| | | Pass due but not impaired | | | |
| | Less than 30 days LKR | 31 to 60 days LKR | 61 to 90 days LKR | More than 90 days LKR | Total LKR |
| 31 December 2018 | | | | | |
| Loans and receivables to other customers (without impairment) | 6,081,797,677 | 4,413,998,529 | 222,108,245 | 2,955,196,012 | 13,673,100,463 |
| 31 December 2017 | | | | | |
| Loans and receivables to other customers (without impairment) | 5,531,449,543 | 3,486,694,869 | 83,868,750 | 1,771,344,105 | 10,873,357,267 |

Impairment assessment (Policy applicable from 1 January 2018) definition of default and cure

The Bank considers a financial instrument defaulted and therefore Stage 3 (credit-impaired) for ECL calculations in all cases when the borrower becomes 90 days past or three instalments in arrears due on its contractual payments.

As a part of a qualitative assessment of whether a customer is in default, the Bank also considers a variety of instances that may indicate unlikelihood to pay. When such events occur, the Bank carefully considers whether the event should result in treating the customer as defaulted and therefore assessed as Stage 3 for ECL calculations or whether Stage 2 is appropriate. Such events (among others) include;

- When contractual payments of a customer are more than 30 days past due;
- When reasonable and supportable forecasts of future economic conditions directly affect the performance of a customer/group of customers, portfolios or instruments;
- When the value of collateral is significantly reduced and/or realisability of collateral is doubtful. Limits shall be set and documented by licensed banks;
- Modification of terms resulting in concessions, including extensions, deferment of payments, waiver of covenants etc.;
- When the customer is deceased/insolvent;
- When the Bank is unable to contact or find the customer.

It is the Bank's policy to consider a financial instrument as "cured" and therefore reclassified out of Stage 3 when none of the default criteria have been present for at least six consecutive months. The decision whether to classify an asset as Stage 2 or Stage 1 once cured depends on the updated credit grade, at the time of the cure, and whether this indicates there has been a significant increase in credit risk compared to initial recognition.

PD estimation process

Probability of default is the estimate of the likelihood of default over a given time horizon. A default may only happen at a time horizon if the facility has not been previously derecognised and is still in the portfolio.

An early exit (EE) may occur in case of default unless the facility reverts to performing without significant modification of the contractual terms. The marginal probability of default for the period is then adjusted from the probability that an early exit occurred during the previous periods.

12 months PD

This is the estimated probability of default occurring within the next 12 months.

The 12 month PD is applied for the "current" and "1-30 days" buckets since there is no significant deterioration in credit risk.

Lifetime PD

This is the estimated probability of default occurring over the remaining life of the financial instrument.

The lifetime PD is applied for the 31-60 days and 61-90 days buckets since there is a significant deterioration in credit risk. The PD for the above 90 days category is 100% since there is objective evidence of impairment as the default has occurred.

Exposure at default

The exposure at default (EAD) represents the gross carrying amount of the financial instruments subject to the impairment calculation, addressing both the client's ability to increase its exposure while approaching default and potential early repayments too.

These components will all need to be estimated based on past experience and future expectations, for sections of the portfolio that are segmented so that they have similar credit characteristics.

Loss given default

Loss given default is the magnitude of likely loss on exposure, and is expressed as a percentage of exposure. These LGD rates take into account the expected EAD in comparison to the amount expected to be recovered or realised from any collateral held.

The Bank segments its retail lending products into smaller homogeneous portfolios, based on key characteristics that are relevant to the estimation of future cash flows. The applied data is based on historically collected loss data and involves a wider set of transaction characteristics (e.g. product type, wider range of collateral types) as well as borrower characteristics.

For each year, closed contracts which have crossed the above 90 days at-least once in their lifetime are considered. LGD will factor in all cash flows subsequent to the point of default until the full settlement of the loan.

Virtually closed contracts are also be added to this data set. Virtually closed contracts are active loans which have been long outstanding. A contract is determined to be virtually closed at the point the Bank determines that the cash flows have dried up.

Significant increase in credit risk

The Bank continuously monitors all assets subject to ECLs. In order to determine whether an instrument or a portfolio of instruments is subject to 12m ECL or LTECL, the Bank assesses whether there has been a significant increase in credit risk since initial recognition.

The Bank also applies a secondary qualitative method for triggering a significant increase in credit risk for an asset, such as an account having been restructured. In certain cases, the Bank may also consider that event as a significant increase in credit risk as opposed to a default.

When estimating ECLs on a collective basis for a group of similar assets, the Bank applies the following in the categorisation of credit facilities/exposures into stages for computation of expected credit loss.

Stage 1

- All credit facilities, which are not categorised under Stages 2 or 3 below.

Stage 2

- Credit facilities, where contractual payments of a customer are more than 30 days past due, other than the credit facilities categorised under Stage 3 below, subject to the rebuttable presumption as stated in SLFRS 9.
- All restructured loans, which are restructured up to two times (other than upgraded restructured facilities, satisfactory performing period of a minimum 90 days considered subsequent to the due date of the 1st capital and/or interest instalment post-restructure).
- Under-performing credit facilities/exposures.

Stage 3

- Credit facilities where contractual payments of a customer are more than 90 days past due or three instalments in arrears, subject to the rebuttable presumption as stated in SLFRS 9.
- All restructured loans, which are restructured more than twice.
- All rescheduled loans, other than credit facilities/exposures (other than upgraded restructured facilities, satisfactory performing period of a minimum 90 days considered subsequent to the due date of the 1st capital and/or interest instalment post-restructure).
- All credit facilities/customers classified as non-performing as per CBSL Directions.
- Non-performing credit facilities/customers.

Grouping financial assets measured on a collective basis

As explained in Note 2.3.2 dependent on the factors below, the Bank calculates ECLs either on a collective or an individual basis.

An individual impairment assessment is performed for exposures over the Individually Significant Threshold of LKR 5 Mn. for which there is objective evidence of expected loss based on the current status of the customer, i.e. based on whether customer is performing, non-performing, rescheduled or watch-listed.

Exposures that are assessed for individual impairment and for which an impairment provision has been recognised are not included in the collective assessment of impairment. If it is determined that no objective evidence of expected loss exists for an individually assessed exposure, or assessed for objective evidence and there is no requirement for individual impairment, whether significant or not, this is included in a group of exposures with similar credit risk characteristics that are collectively assessed for impairment under the relevant bucket.

A collective assessment is performed for exposures as follows:

- Exposures that have not been individually assessed i.e. falling below the individually significant threshold
- Exposures that have been assessed for Objective Evidence of Incurred Loss and were found to have no such evidence of expected loss
- Exposures that have been individually assessed and were found not to be impaired on an individual basis based on the cash flow estimation

The Bank groups these exposure into homogeneous portfolios to extent possible so as ensure that data point available for meaningful calculations.

Impairment assessment (policy applicable before 1 January 2018)

For accounting purposes, the Bank uses an incurred loss model for the recognition of losses on impaired financial assets. This means that losses can only be recognised when objective evidence of a specific loss event has been observed. Triggering events include the following:

- Significant financial difficulty of the customer.
- A breach of contract such as a default of payment.
- Where the Bank grants the customer a concession due to the customer experiencing financial difficulty.
- It becomes probable that the customer will enter bankruptcy or other financial reorganisation.
- Observable data that suggests that there is a decrease in the estimated future cash flows from the loans.

This approach differs from the expected loss model used for regulatory capital purposes in accordance with Basel III.

Individually-assessed allowances

The Bank determines the allowances appropriate for each individually significant loan or advance on an individual basis, include any overdue payments of interests or infringement of the original terms of the contract. Items considered when determining allowance amounts include the sustainability of the counterparty's business plan, its ability to improve performance once a financial difficulty has arisen, projected receipts and the expected payout should bankruptcy ensue, the availability of other financial support, the realisable value of collateral and the timing of the expected cash flows. Impairment allowances are evaluated at each reporting date, unless unforeseen circumstances require more careful attention.

Collectively-assessed allowances

Allowances are assessed collectively for losses on loans and advances and other debt investments that are not individually significant (including residential mortgages and unsecured consumer lending) and for individually significant loans and advances that have been assessed individually and found not to be impaired. The Bank generally bases its analyses on historical experience.

The Bank may use the aforementioned factors as appropriate to adjust the impairment allowances.

Allowances are evaluated separately at each reporting date with each portfolio.

The collective assessment is made for groups of assets with similar risk characteristics, in order to determine whether provision should be made due to incurred loss events for which there is objective evidence, but the effects of which are not yet evident in the individual loans assessments. The collective assessment takes account of data from the loan portfolio (such as historical losses on the portfolio, levels of arrears, credit utilisation, loan to collateral ratios and expected receipts and recoveries once impaired). The approximate delay between the time a loss is likely to have been incurred and the time it will be identified as requiring an individually-assessed impairment allowance is also taken into consideration. Local management is responsible for deciding the length of this period which can extend for as long as one year. The impairment allowance is then reviewed by credit management to ensure alignment with the Bank's overall policy. Financial guarantees and letters of credit are assessed and provisions are made in a similar manner as for loans.

Commitments and guarantees

To meet the financial needs of customers, the Bank enters into various commitments and contingent liabilities. Even though these obligations may not be recognised on the Statement of Financial Position, they do contain credit risk and are therefore part of the overall risk of the Bank. Financial statement has separately disclosed the Bank's maximum credit risk exposure for commitments and guarantees.

41.3 Liquidity risk and funding management

Liquidity risk is defined as the risk that the Bank will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset. Liquidity risk arises because of the possibility that the Bank might be unable to meet its payment obligations when they fall due under both normal and stress circumstances. To limit this risk, management has arranged diversified funding sources in addition to its core deposit base, and adopted a policy of managing assets with liquidity in mind and of monitoring future cash flows and liquidity on a daily basis. The Bank has developed internal control processes and contingency plans for managing liquidity risk. This incorporates an assessment of expected cash flows and the availability of high grade collateral which could be used to secure additional funding if required.

The Bank maintains a portfolio of highly marketable and diverse assets that assumed to be easily liquidated in the event of an unforeseen interruption of cash flow. The Bank also has committed lines of credit that it can access to meet liquidity needs. In accordance with the Bank's policy the liquidity position is assessed and managed under a variety of scenarios, giving due consideration to stress factors relating to both the market in general and specifically to the Bank. The most important of these is to maintain limits on the ratio of net liquid assets to customer liabilities, to reflect market conditions. Liquid assets consist of cash, short-term bank deposits and Treasury bills available for immediate sale.

The Bank stresses the importance of term accounts and savings accounts as sources of funds to finance lending to customers. They are monitored using the advances to deposit ratio, which compares loans and advances to customers as a percentage of customer savings accounts, together with term funding with a remaining term to maturity.

Analysis of financial assets and liabilities by remaining contractual maturities

The table below summarises the maturity profile of the undiscounted cash flows of the Bank's financial assets and liabilities as at 31 December. The Bank expects that many customers will not request repayment on the earliest date the Bank could be required to pay and the table does not reflect the expected cash flows indicated by the Bank's deposit retention history:

| Maturity analysis 2018 | Less than 7 Days LKR | 7-30 Days LKR | 1-3 Months LKR | 3-12 Month LKR | 1-3 Years LKR | 3-5 Years LKR | Over 5 Years LKR | Total LKR |
|------------------------------------------|-------------------------|----------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|------------------------|
| Financial assets | | | | | | | | |
| Cash and cash equivalents | 4,171,938,630 | - | - | - | - | - | - | 4,171,938,630 |
| Investments | 3,466,827,144 | 5,764,834,724 | 3,834,399,122 | 30,599,084 | 96,802,800 | 60,148,048 | - | 13,253,610,920 |
| Loans and receivables to other customers | 1,416,410,358 | 2,117,141,125 | 3,269,857,395 | 15,520,336,642 | 23,958,709,739 | 17,900,396,885 | 25,835,847,050 | 90,018,699,193 |
| Total financial assets | 9,055,176,132 | 7,881,975,848 | 7,104,256,516 | 15,550,935,726 | 24,055,512,539 | 17,960,544,933 | 25,835,847,050 | 107,444,428,744 |
| Financial liabilities | | | | | | | | |
| Due to other customers | 2,782,918,433 | 4,192,909,422 | 10,733,966,507 | 31,340,676,236 | 12,710,070,042 | 5,875,048,928 | 3,345,510,561 | 70,981,100,128 |
| Other borrowings | - | 283,182,271 | 1,809,763,544 | 4,089,634,458 | 9,417,061,777 | 5,606,886,353 | 45,854,456 | 21,252,382,859 |
| Debt securities issued | - | - | - | 1,013,630,925 | - | - | - | 1,013,630,925 |
| Total financial liabilities | 2,782,918,433 | 4,476,091,692 | 12,543,730,051 | 36,443,941,619 | 22,127,131,819 | 11,481,935,281 | 3,391,365,017 | 93,247,113,912 |
| Net financial assets/(liabilities) | 6,272,257,699 | 3,405,864,156 | (5,439,473,535) | (20,893,005,893) | 1,928,380,720 | 6,478,609,652 | 22,444,482,033 | 14,197,134,832 |
| Maturity analysis 2017 | | | | | | | | |
| Maturity analysis 2017 | Less than 7 Days LKR | 7-30 Days LKR | 1-3 Months LKR | 3-12 Month LKR | 1-3 Years LKR | 3-5 Years LKR | Over 5 Years LKR | Total LKR |
| Financial assets | | | | | | | | |
| Cash and cash equivalents | 1,190,389,606 | - | - | - | - | - | - | 1,190,389,606 |
| Investments | 1,261,352,776 | 2,566,281,288 | 6,112,613,027 | 2,551,080,736 | 135,068,944 | 166,276,813 | - | 12,792,673,584 |
| Loans and receivables to other customers | 1,112,727,976 | 1,710,281,932 | 2,591,290,984 | 12,452,044,561 | 20,081,278,906 | 16,550,747,457 | 22,580,251,905 | 77,078,623,721 |
| Total financial assets | 3,564,470,358 | 4,276,563,221 | 8,703,904,011 | 15,003,125,298 | 20,216,347,851 | 16,717,024,270 | 22,580,251,905 | 91,061,686,912 |
| Financial liabilities | | | | | | | | |
| Due to other customers | 1,857,449,478 | 5,986,894,014 | 11,788,193,037 | 25,159,935,467 | 10,648,181,107 | 4,843,891,238 | 2,813,736,284 | 63,098,280,625 |
| Other borrowings | - | 199,808,268 | 403,712,812 | 2,586,321,829 | 5,923,513,726 | 2,194,886,508 | 198,764,300 | 11,507,007,443 |
| Debt securities issued | - | - | - | 3,183,298,195 | 1,013,630,925 | - | - | 4,196,929,120 |
| Total financial liabilities | 1,857,449,478 | 6,186,702,282 | 12,191,905,849 | 30,929,555,490 | 17,585,325,758 | 7,038,777,746 | 3,012,500,584 | 78,802,217,188 |
| Net financial assets/(liabilities) | 1,707,020,880 | (1,910,139,062) | (3,488,001,838) | (15,926,430,193) | 2,631,022,093 | 9,678,246,524 | 19,567,751,321 | 12,259,469,724 |

41.4 Market risk

Market risk is the risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables. The bank classifies exposures to market risk into either trading or non-trading portfolios and manages each of those portfolios separately. The market risk for the portfolio is managed and monitored using sensitivity analyses.

Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect future cash flows or the fair values of financial instruments.

The table below analyses the Bank's interest rate risk exposure on financial assets and liabilities.

The Bank's assets and liabilities are included at carrying amount and categorised by the earlier of contractual re-pricing or maturity dates.

Interest rate sensitivity asset 2018

| Asset or liability | Carrying amount LKR | On demand LKR | 1-3 Months LKR | 3-12 Month LKR | Over 1 Year LKR | Non- interest LKR | Total LKR |
|--------------------------------------------------------------|------------------------|----------------------|------------------------|-------------------------|-----------------------|------------------------------------------------------------------|-----------------------------------------------------------------|
| Cash and cash equivalents | 4,171,938,630 | 301,146,575 | – | – | – | 3,870,792,055 | 4,171,938,630 |
| Placements with banks | 9,528,425,565 | 6,100,000,000 | 3,250,000,000 | 178,425,565 | – | – | 9,528,425,565 |
| Other financial asset classified under loans and receivables | – | – | – | – | – | – | – |
| Financial investments – Held to maturity | – | – | – | – | – | – | – |
| Loans and receivables to other customers | 77,507,021,162 | 3,040,896,001 | 2,813,966,720 | 11,358,518,596 | 58,256,775,070 | 2,036,864,775 | 77,507,021,162 |
| Interest-bearing assets | 91,207,385,357 | 9,442,042,576 | 6,063,966,720 | 11,536,944,161 | 58,256,775,070 | 5,907,656,830 | 91,207,385,357 |
| Due to other customers | 67,474,821,535 | 6,322,925,433 | 9,729,321,198 | 31,544,542,057 | 19,878,032,846 | – | 67,474,821,534 |
| Other borrowings | 15,420,967,962 | 282,415,255 | 1,791,301,041 | 4,147,422,945 | 9,199,828,723 | – | 15,420,967,963 |
| Debt securities issued | 4,198,547,716 | 3,035,440,000 | – | 198,547,716 | 964,560,000 | – | 4,198,547,716 |
| Subordinated term debts | 1,008,027,823 | – | – | 15,058,060 | 992,969,761 | – | 1,008,027,821 |
| Interest-bearing liabilities | 88,102,365,036 | 9,640,780,687 | 11,520,622,239 | 35,905,570,778 | 31,035,391,330 | – | 88,102,365,034 |
| Interest rate sensitivity gap | 3,105,020,321 | (198,738,111) | (5,456,655,519) | (24,368,626,617) | 27,221,383,740 | 5,907,656,830 | 3,105,020,323 |
| | | | | | | If market interest rate go up by 1% effect to interest income | If market interest rate drop by 1% effect to interest income |
| Effect on rate sensitive assets | | | | | | 912,073,854 | 881,023,650 |
| Effect on rate sensitive liabilities | | | | | | (881,023,650) | (912,073,854) |
| Sensitivity of profit or loss | | | | | | 31,050,203 | (31,050,203) |

Interest rate sensitivity asset 2017

| Asset or Liability | Carrying amount LKR | On demand LKR | 1-3 Months LKR | 3-12 Month LKR | Over 1 Year LKR | Non-interest LKR | Total LKR |
|--------------------------------------------------------------|------------------------|------------------------|------------------------|-------------------------|-----------------------|------------------------------------------------------------------|-----------------------------------------------------------------|
| Cash and cash equivalents | 1,190,389,606 | 301,146,575 | – | – | – | 889,243,031 | 1,190,389,606 |
| Placements with banks | 6,014,703,836 | 900,000,000 | 3,200,000,000 | 1,914,703,836 | – | – | 6,014,703,836 |
| Other financial asset classified under loans and receivables | 1,479,949,628 | 1,001,736,169 | 287,722,693 | 26,810,765 | 163,680,000 | – | 1,479,949,628 |
| Financial investments – Held to maturity | 599,551,021 | 350,000,000 | – | 249,551,021 | – | – | 599,551,021 |
| Loans and receivables to other customers | 66,687,415,593 | 2,436,082,864 | 2,236,123,771 | 9,516,088,143 | 51,096,532,120 | 1,402,588,695 | 66,687,415,593 |
| Interest-bearing assets | 75,972,009,684 | 4,988,965,609 | 5,723,846,465 | 11,707,153,765 | 51,260,212,120 | 2,291,831,726 | 75,972,009,684 |
| Due to other customers | 59,904,734,365 | 7,116,025,898 | 10,693,703,945 | 25,488,820,917 | 16,606,183,605 | – | 59,904,734,365 |
| Other borrowings | 8,827,609,604 | 199,285,886 | 399,069,557 | 2,734,900,011 | 5,494,354,151 | – | 8,827,609,604 |
| Debt securities issued | 4,189,812,218 | – | – | 189,812,218 | 4,000,000,000 | – | 4,189,812,218 |
| Subordinated term debts | 1,004,354,742 | – | – | 30,651,824 | 973,701,918 | – | 1,004,353,742 |
| Interest-bearing liabilities | 73,926,510,929 | 7,315,311,784 | 11,092,773,502 | 28,444,184,970 | 27,074,239,674 | – | 73,926,509,929 |
| Interest rate sensitivity gap | 2,045,498,755 | (2,326,346,175) | (5,368,927,038) | (16,737,031,205) | 24,185,972,446 | 2,291,831,726 | 2,045,499,756 |
| | | | | | | If market interest rate go up by 1% effect to interest income | If market interest rate drop by 1% effect to interest income |
| Effect on rate sensitive assets | | | | | | 759,720,097 | 739,265,109 |
| Effect on rate sensitive liabilities | | | | | | (739,265,109) | (759,720,097) |
| Sensitivity of profit or loss | | | | | | 20,454,988 | (20,454,988) |

Equity price risk

Equity price risk is the risk that the fair value of equities decreases as the result of changes in the level of equity indices and individual stocks. The non-trading equity price risk exposure arises from equity securities classified as available for sale.

42. Capital

The Bank maintains an actively managed capital base to cover risks inherent in the business. The adequacy of the bank's capital is monitored using, among other measures, the rules and ratios established by the Basel Committee on Banking Supervision (BIS rules/ratios) and adopted by the Central Bank of Sri Lanka.

During the past year, the Bank had complied in full with all its externally imposed capital requirements.

Capital management

The primary objectives of the Bank's capital management policy are to ensure that the Bank complies with externally imposed capital requirements and that the Bank maintains strong credit ratings and healthy capital ratios in order to support its business and to maximise shareholder value.

The Bank manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities. In order to maintain or adjust the capital structure, the Bank may adjust the amount of dividend payment to shareholders, return capital to shareholders or issue capital securities.

43. Transition disclosures

The following disclosure set out the impact of adopting SLFRS 9 on the Statement of Financial Position, and retained earnings including the effect of replacing LKAS 39's incurred credit loss calculations with SLFRS 9's expected credit losses.

A reconciliation between the carrying amounts under LKAS 39 to the balances reported under SLFRS 9 as of 1 January 2018 is, as follows:

First Day Impact

| Bank (Audited) as at 1 January 2018 | LKAS 39 measurement | | | | Remeasurement SLFRS 9 | | |
|--------------------------------------------------------------------------------|---------------------|----------|-----------------|------------------|-----------------------|----------|-----------------------|
| | Note | Category | Amount | Reclassification | ECL | Category | Amount |
| Financial assets | | | | | | | |
| Cash and cash equivalents | | AC | 1,190,389,606 | - | - | AC | 1,190,389,606 |
| Less: Impairment | | | | | (15,190) | | (15,190) |
| Carrying value after impairment | | | | | | | 1,190,374,416 |
| Placements with banks | | AC | 6,014,703,836 | - | - | AC | 6,014,703,836 |
| Less: Impairment | | | - | - | (1,800,323) | | (1,800,323) |
| Carrying value after impairment | | | | | | | 6,012,903,513 |
| Financial assets fair value through profit or loss | | FVPL | 4,473,805,573 | - | | FVPL | 4,473,805,573 |
| To: Debts and other instruments | | | | 2,079,500,649 | | AC | 2,079,500,649 |
| From: Other financial asset classified under loans and receivable | A | L&R | 1,479,949,628 | (1,479,949,628) | - | | - |
| From: Financial investments – Held-to-maturity | C | HTM | 599,551,021 | (599,551,021) | - | | - |
| Less: Impairment | | | | | (332,239) | | (332,239) |
| Carrying value after impairment | | | | | | | 2,079,168,410 |
| Loans and receivables to other customers | | L&R | 68,104,871,364 | - | - | AC | 68,104,871,364 |
| Less: Individual impairment | | | (220,946,259) | - | - | | (220,946,259) |
| Collective impairment | | | (1,196,509,512) | - | (49,316,676) | | (1,245,826,188) |
| Carrying value after impairment | | | | | | | 66,638,098,918 |
| From: Financial investments – Available-for-sale | B | AFS | 63,536,159 | (63,536,159) | - | | - |
| To: Financial assets measured at fair value through other comprehensive income | | | | 63,536,159 | | FVOCI | 63,536,159 |
| | | | 80,509,351,416 | - | (51,464,427) | | 80,457,886,989 |
| Non-financial liabilities | | | | | | | |
| Deferred tax liability | D | | 58,000,392 | - | (14,410,040) | | 43,590,352 |
| Equity | | | | | | | |
| Retained earnings | E | n/a | 1,340,503,863 | - | (37,054,387) | n/a | 1,303,449,476 |

- A. As at 1 January 2018 financial assets previously classified as other loans and receivables have been reclassified as debt and other instruments at amortised cost.
- B. Financial assets previously classified under available-for-sale category have been reclassified as financial assets fair value through other comprehensive income (FVOCI) upon adoption of SLFRS 9.
- C. As at 1 January 2018, the Bank elected to classified its previous held to maturity portfolios as debt and other instruments measured at amortised cost.
- D. The impact of SLFRS 9 remeasurements on deferred tax is set out below under E .
- E. The impact on retained earning by transition to SLFRS 9 is as follows:

| | LKR |
|----------------------------------------------------------|----------------------|
| Closing Balance under LKAS 39 as at 31 December 2017 | 1,340,503,863 |
| Remeasurement adjustment on adoption of SLFRS 9 | |
| Recognition of SLFRS 9 ECLs for loans and investments | (51,464,427) |
| Deferred tax on above | 14,410,040 |
| Total change in equity due to adoption of SLFRS 9 | (37,054,387) |
| Closing Balance under LKAS 9 as at 1 January 2018 | 1,303,449,476 |

The following table reconciles the aggregate opening credit loss provision under LKAS 39 to the ECL allowances under SLFRS 9:

| | Loan loss provision under LKAS 39 as at 31 December 2017 LKR | Remeasurement LKR | ECL impairment under SLFRS 9 as at 1 December 2018 LKR |
|------------------------------------------|--------------------------------------------------------------------------|--------------------------|--------------------------------------------------------------------|
| Cash and cash equivalents | – | 15,190 | 15,190 |
| Placements with banks | – | 1,800,323 | 1,800,323 |
| Financial assets at amortise cost: | | | |
| Loans and receivables to other customers | 1,417,455,771 | 49,316,676 | 1,466,772,447 |
| Debts and other instruments | – | 332,239 | 332,239 |
| | 1,417,455,771 | 51,464,428 | 1,468,920,199 |