Independent Auditors' Report

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TO THE SHAREHOLDERS OF DFCC BANK PLC

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of DFCC Bank PLC ("the Bank") and the consolidated financial statements of the Bank and its subsidiaries ("the Group"), which comprise the statement of financial position as at 31 December 2019, and income statement, statements of profit or loss and other comprehensive income, changes in equity and cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies as set out on pages 146 to 282 of this Annual Report.

In our opinion, the accompanying financial statements of the Bank and the Group give a true and fair view of the financial position of the Bank and the Group as at 31 December 2019, and of their financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

Basis for opinion

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

Key audit matters

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

Impairment of loans and advances – "Financial Instruments"

Refer to Note 4 (Use of Judgements and Estimates), Note 17 (Impairment for Loans and Other Losses), Note 31 (Loans to and receivables from banks) and Note 32 (Loans to and receivables from other customers), to these Financial Statements.

Risk Description	Our Responses
As disclosed in Notes 31 and 32 to these financial statements, the Bank has recorded loans to and receivables from banks and loans to and receivables from other customers of LKR 8,485 Mn and LKR 285,225 Mn respectively as at 31 December 2019. High degree of complexity and judgement involved in estimating individual and collective impairment of LKR 82 Mn and LKR 12,406 Mn respectively as at that date. Given the complexity of SLFRS 9 and its pervasive impact on the financial sector we focused on the Bank's disclosure of the impact of measuring expected credit losses (ECL) on loans and receivables and the significant judgement exercised by the Bank. The models used by the Bank. to calculate ECLs are inherently complex and judgement is applied in determining the correct construct of the models. There are also a number of key assumptions made by the Bank in applying the requirements of SLFRS 9 to these models including selection and input of forward looking information The allowance for credit impairment has been identified as a key audit matter as the Bank has significant credit exposure to number of customers across a wide range of lending and other products and industries.	Our audit procedures to assess impairment of loans and advances to customers included the following: **Assessing impairment for individually significant customers** → We selected a sample (based on quantitative thresholds) of larger customers where impairment indicators have been identified by Management. We obtained Management's assessment of the recoverability of these exposures (including individual impairment calculations) and assessed whether individual impairment provisions, or lack of, were appropriate. **This included the following procedures:** → Challenging recoverability of the forecasted cash flows by comparing them to the historical performance of the customers and the expected future performance where applicable; → Assessing external collateral valuer's credentials and comparing external valuations to values used in Management's impairment assessments. → For a sample of customers loans which were not identified as displaying indicators or impairment by Management, challenged this assessment by reviewing the historical performance of the customers and from our own view whether any impairment indicators were present. **Assessing the adequacy of collectively assessed provisions** → Testing governance and controls over the application of collective provision model adjustments. This included assessing the components of model adjustments, trends in the credit risk concentration of specific portfolios and our understanding of economic conditions. → Performing analytical procedures to independently derive an estimate and compared to the Bank's collective provisions. → Testing the completeness and accuracy of key assumptions and data flows into the collective provision models. → Assessing the disclosures in the financial statements against the requirements of Sri Lanka Accounting Standards.

IT systems and controls over financial reporting

Risk description	Our responses
The Bank's key financial accounting and reporting processes are highly dependent on the automated controls over the Bank's information systems. As such that there exist a risk that lapses in the IT control environment, including automated accounting procedures, IT dependent manual control, controls preventing unauthorised access, changes to IT systems and data are critical to the recording financial information and could result in the financial reporting/accounting records being materially misstated. The IT systems and controls, as they impact the financial recording and reporting of transactions, is a key audit matter and our audit approach could significantly differ depending on the effective operation of the Bank's IT controls.	We used our internal IT specialists to perform audit procedures to assess IT systems and controls over financial reporting, which included the following: **General IT controls design, observation and operation** → Assessing the governance and higher-level controls in place across the IT Environment, including the approach to Group policy design, review and awareness, and IT Risk Management practices. → Testing the sample of key controls operating over the information technology in relation to financial accounting and reporting systems, including system access and system change management, programme development and computer operations **User access controls operation** → Assessing the Management's evaluation of access rights granted to applicants relevant to financial accounting and reporting systems and tested resolution of a sample of exceptions. → Assessing the operating effectiveness of controls over granting, removal, and appropriateness of access rights.

Other information

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

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

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

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

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

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

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

Auditors' responsibilities for the audit of the financial statements

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

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

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

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

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

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

Report on other legal and regulatory requirements

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

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

KPMG

Chartered Accountants

Colombo, Sri Lanka

18 February 2020