COMPENDIUM 2018

Our ethos... our strength

NATIONAL SAVINGS BANK

The National Savings Bank was established in 1972 through a Parliamentary Act that amalgamated four traditional savings organisations in the country into one establishment. At its inception, NSB inherited a savings legacy of over a century old from its predecessor the Ceylon Savings Bank (CSB) established in 1832.

NSB was granted the status of a Licensed Specialised Bank under the Banking Act No. 30 of 1988 to foster a savings culture in all Sri Lankans irrespective of class, race and gender. The Bank holds 20.4 million accounts that attest to the claim of being the bank for all segments of society.

As the only bank in the country offering 100% Government guarantee on all deposits and the interest thereon, NSB is the safest Bank in the country. NSB was rated as the "Safest Bank" in Sri Lanka by Global Finance Magazine for the 3rd consecutive year.

Firmly rooted in the national economy, NSB serves the nation by contributing to the General Treasury by way of taxes, levies, fees, and dividend. By its statute, NSB invests minimum 60% of its deposits in guilt-edged Government securities.

NSB participates in nation building by funding long-term development projects, socio-economic projects of the Government, and helps the Government to maintain stability and sustainability of the financial system.

Equipped with long-term, sustainable business strategies and possessing one of the most experienced corporate management teams in the country, NSB is committed to promote financial inclusivity to empower the Nation to achieve economic strength and financial security.

Vision

To be the most reliable and sought-after choice for your savings.

Mission

Providing our customers with total financial solutions to optimise their savings and investment needs, while meeting the expectations of all our stakeholders.

Values

In conducting business we will respond decisively to resonate trust, mutual respect, integrity and creativity.

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Corporate Governance

Our governance philosophy

Corporate governance is the framework that defines the relationship between shareholders, the Board of Directors, Management and other stakeholders, to help influence how an organisation operates. It aims to protect shareholder rights, enhance disclosure and transparency, facilitate effective functioning of the Board and provide an efficient legal and regulatory enforcement framework. A good governance system focuses on highest standards of business ethics, well-constructed policies and procedures and productive monitoring systems within the organisation. Therefore, the essence of Corporate Governance is accountability to all its stakeholders.

We believe Corporate Governance should stem from the corporate culture and values of the Bank and represents far more than legislative compliance and best-practice principles. Hence, the Bank has inculcated a culture that values sound corporate governance for safeguarding stakeholders' interest in conformity with public interest on a sustainable basis. We therefore embrace world class banking practices and robust institutional frameworks to ensure our banking services are secure and stable. These practices are continuously reviewed to ensure that we consistently act in the best interest of our shareholder.

NSB applies the core principles of good corporate governance; fairness, accountability, responsibility and transparency in its governance framework to outperform as the Bank believes good corporate governance is a key factor in underpinning the integrity and efficiency within the Bank.

In our efforts to improve the quality of implementation of good corporate governance, NSB always follow the strategy of periodically performing a self-assessment of the adequacy of implementation of good corporate governance with evolving regulations and best practices which are becoming increasingly rigorous and onerous. This supports the Board in spearheading the stewardship role of the Bank and delegating them across Management and the staff, resource allocation, risk management, compliance, performance appraisal and compensation, related party transactions and financial reporting.

Key regulatory requirements and voluntary codes relevant to the Bank and elements of the corporate governance framework of the Bank →

The Corporate Governance Framework of the Bank is mandated by the regulatory framework as well as the voluntary codes.

Regulatory requirements →

- NSB Act No. 30 of 1971 and amendments therein
- Banking Act No. 30 of 1988 and amendments thereto
- All Directions issued to Licensed Specialised Banks by the Central Bank of Sri Lanka (CBSL) particularly the Banking Act Direction No. 12 of 2007 on Corporate Governance
- Inland Revenue Act No. 24 of 2017
- Shop and Office Act No. 19 of 1954 and amendments thereto
- Code of Best Practice in Corporate Governance for Public Enterprises in Sri Lanka

Voluntary codes relevant to the Bank →

- Code of Best Practice on Corporate Governance issued by CA Sri Lanka for the Governance Code

Corporate governance framework of NSB →

NSB is committed to high standard of governance, ethics and integrity. The Bank operates within a clearly defined Board approved governance framework, which provides the guidance to implement robust governance practices and clear direction for decision making throughout the Bank. The Board is the apex governance body of the Bank and has ultimate accountability and responsibility for the performance and affairs and ensures that the Bank adheres to high standards of ethical behaviour. Our Board of Directors provide leadership and strategic direction to safeguard shareholder value creation within a framework of prudent and effective controls. This enables risk to be assessed and managed to ensure long-term sustainable development and growth. The Board is assisted by Board Subcommittees, Management committees and Corporate

Management. Management Committees and the Corporate Management are responsible for executing the strategies approved by the Board. Strategic Business Lines and support functions are responsible for carrying out the operations within the pre-defined risk appetite level of the Bank. The governance structure of the Bank is given on page 150

Governance framework at NSB is based on the following principles:

- Assuming responsibility and accountability in respect of the Management of affairs of NSB at all levels.
- Ensuring the oversight of specific responsibilities assigned to the Board through Board-appointed Subcommittees.
- Determining the best structures of management for the Bank to achieve its business objectives.
- Striking a balance between business and the true spirit of "National Savings" and delegating Key Management Personnel appropriately.
- Evaluating business activities and prudent risk management policies of the Bank to create a safe and sound environment.
- Infusing and accommodating new ideas and maintaining cordial relationships at Board and Senior Management levels.
- Having an active role in discussing with relevant regulatory bodies on the implementation and complying with governance regulations.
- Overseeing internal control systems including internal audit, compliance and risk management functions independent from the business lines.
- Adhering to all requirements of the NSB Act, laws and directions of regulators.
- Keeping social responsibility in mind when carrying out its core activities.

Policy framework

The policy framework of the Bank is key to sound Corporate Governance. Compliance with external regulations is facilitated through a comprehensive policy framework. Collectively, they define how we do business and reflect our approach to compliance, managing stakeholders' expectations and risk. Policy documents are typically modelled on international best practice, ensuring compliance with regulatory requirements as appropriate to the Bank's size, systemic importance and the specific operational context.

Compliance

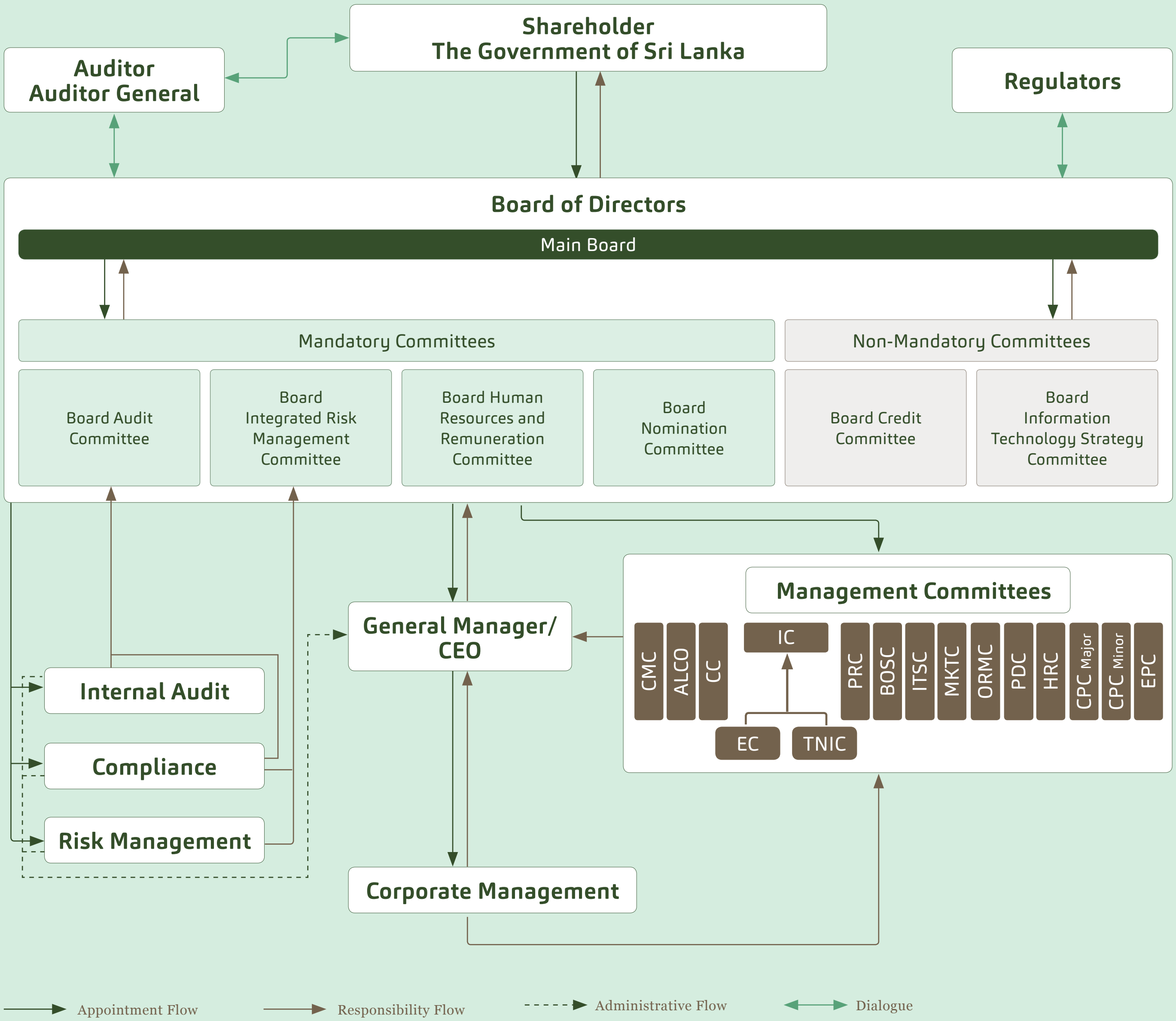
Directors are conscious of their duty to comply with the laws, regulations, regulatory guidelines, internal controls and approved policies on all areas of business of the Bank. Bank is compliant with all relevant legal and statutory requirements. The Bank has implemented controls to provide reasonable assurance of its compliance, including establishment of a compliance function.

This function is spearheaded by a dedicated Compliance Officer who reports to the Board Integrated Risk Management Committee (BIRMC). The Compliance Officer submits a report on mandatory banking and statutory requirements on a quarterly basis to the BIRMC.

Corporate Governance

Governance Structure of National Savings Bank

GRI 102-18



CMC	Corporate Management Committee	**ITSC**	IT Steering Committee	**CPC-Minor**	Corporate Procurement Committee – Minor
ALCO	Assets Liability Management Committee	**MKTC**	Marketing Committee	**EC**	Equity Committee
CC	Credit Committee	**ORMC**	Operational Risk Management Committee	**TNIC**	Tender and New Investment Committee
IC	Investment Committee	**PDC**	Product Development Committee	**EPC**	Executive Procurement Committee
PRC	Performance Review Committee	**HRC**	Human Resources Committee		
BOSC	Branch Operations Steering Committee	**CPC-Major**	Corporate Procurement Committee – Major		

Our Board of Directors

The Board of Directors of NSB serves as the apex decision-making authority of the Bank and is responsible for determining the strategic direction based on the agreed risk appetite level and the policy framework to achieve those strategies. The Board has delegated the Corporate Management to carry out the day-to-day operations of the Bank without abdicating the Board's responsibility and implementing and monitoring the internal controls. These engagements take place with mutual respect and candour.

The Board Charter details the roles and responsibilities of the Board. The Board is committed to act in best interests of the Bank while adopting a pragmatic approach to the Bank's core business, prudently evaluating the inputs of its business model, assessing the impact of the operating environment on these inputs as well as the potential trade-off. As a financial intermediary with a Government mandate, it is critical that the Bank remains relevant and innovative to achieve its vision "to be the most reliable and sought-after choice for your savings". Hence, the Board is committed to ensure the Bank remains agile to cater rapidly changing customer and stakeholder needs.

The present Board comprises seven Directors who are experienced professionals in their chosen fields of expertise and skills to carry out deliberations on matters set before the Board. Six Directors of the present Board are Non-Independent and Non-Executive while one Director is independent and Non-Executive.

Profiles of the present Directors including their qualifications, are given on pages 131 to 133 and the details of their membership in Board Subcommittees are given on page 154.

Board process

The Board meets at least once in six weeks as per the NSB Act based on an agreed meeting schedule. Additional meetings are convened based on the requirements to do so. Directors attend regularly to the meetings and actively participate in the deliberations. Details of attendance at Board meetings during the year 2018 are given on page 152 The Chairman is responsible for determining the agenda of meetings with assistance of the Secretary to the Board in consultation with the General Manager/CEO. The agenda is circulated to the Board members along with the relevant Board papers prior to one week of the Board meetings by the Secretary to the Board. This process allows the Board for timely preparation and make deliberations and informed decision. On exceptional situations, urgent Board papers are submitted at short notice or tabled during the meetings. Adequately detailed minutes of the meetings and the decisions made therein are maintained to access by Directors.

Conflict of interest

The members of the Board are committed to act in the best interest of the Bank, in good faith and avoid undue conflicts of interest whether financially or otherwise. Any banking facilities provided to the Directors are in compliance with the authorisation given by the CBSL. Directors annually declare their interest and necessary procedures are in place to ensure that there is no conflict of interest.

Board meetings

The Board meetings are held at least once in every six weeks according to the provision of NSB Act and special meetings are held when the need arises. The Board of Directors held 17 scheduled meetings during the year inclusive of special meetings. The Board directed the Management for the preparation of Strategic Business Plan for three years, which is rolled over annually. During the year under review, the Board continued to focus on capital management with the implementation of the CBSL Direction No. 1 of 2016 that includes the increased Basel III Capital Adequacy Ratio, which will be fully-implemented with effect from 1 January 2019. Further, the Board quarterly reviewed the performance and implementation of Strategic Business Plan and deliberated on matters that require further attention.

Corporate Governance

The details of meetings of the Board are given below:

Composition of the Board and attendance for the year 2018

Name of the Director	Age (Years)		Membership status		Gender		DOA	Meeting attendance	
	Below 60 years	Above 60 years	NED/ED	ID/NID	Male	Female		Eligible to attend	Attended
Mr Aswin De Silva – Chairman (up to 12 November 2018)	x		NED	NID	x		9 February 2015	15	15
Mr R M P Rathnayake – Chairman (up to 19 February 2019)	x		NED	NID	x		19 November 2018	2	2
Mr D L P R Abeyaratne – Ex Officio Director (up to 11 July 2018)	x		NED	NID	x		9 February 2012	9	6
Mr Suranga Naullage – Director (up to 31 December 2018)		x	NED	NID	x		9 February 2015	17	16
Mr Ajith Pathirana – Director (up to 19 July 2018)	x		NED	NID	x		20 March 2015	10	9
Mr A K Seneviratne – Ex Officio Director (up to 28 February 2019)	x		NED	NID	x		27 May 2015	17	14
Mr Chandima Hemachandra – Director (up to 19 July 2018)	x		NED	NID	x		2 November 2015	10	10
Mr Anil Rajakaruna – Senior Director (up to 31 December 2018)		x	NED	NID	x		2 November 2015	17	17
Ms Shehara Jayawardana – Director (up to 12 November 2018)	x		NED	NID		x	19 July 2018	4	3
Dr D Shanmugasundaram – Director		x	NED	NID	x		19 July 2018	6	6
Mr U G R Ariyaratne – Ex Officio Director	x		NED	ID	x		31 August 2018	5	5

NED: Non-Executive Director ID: Independent Director DOA: Date of appointment ED: Executive Director NID: Non-Independent Director

Composition of the Present Board

Name of the Director	Age (Years)		Membership status		Gender		DOA
	Below 60 years	Above 60 years	NED/ED	ID/NID	Male	Female	
Mr H N J Chandrasekera – Chairman		x	NED	NID	x		31 January 2019
Mr Anil Rajakaruna – Senior Director (up to 31 December 2018 and reappointed on 22 February 2019)		x	NED	NID	x		22 February 2019
Dr D Shanmugasundaram – Director		x	NED	NID	x		19 July 2018
Mr U G R Ariyaratne – Ex Officio Director	x		NED	ID	x		31 August 2018
Mr Ajith Pathirana – Director (up to 19 July 2018 and reappointed on 22 February 2019)	x		NED	NID	x		22 February 2019
Mr Nazri Nizar – Director	x		NED	NID	x		22 February 2019
Mr P Algama – Ex Officio Director	x		NED	NID	x		28 February 2019

Board subcommittees

With the objective of inculcating a sound governance framework in the Bank, the Board has delegated its authority to six Board Subcommittees. These committees are established to deal with specific subject matters. The six Board Subcommittees include four mandatory committees namely, Board Audit Committee (BAC), Board Integrated Risk Management Committee (BIRMC), Board Human Resources and Remuneration Committee (BHRRC), Board Nomination Committee (BNC) and two voluntary committees namely; Board Credit Committee (BCC) and Board Information Technology Strategy Committee (BITSC) are given the authority to make recommendations to the Board on matters under their purview.

These committees are established as per the Board-approved Terms of Reference which are based on regulatory requirements as well as industry best practices. The committees hold regular meetings and the proceedings are reported to the Board. The Board Subcommittee Reports which details on responsibilities, activities in 2018, the movements of directors in 2018, attendance and number of meetings held during the year 2018 are given on pages 179 to 193 The Secretary to the Board is also the Secretary to all Board Subcommittees. Minutes of the meetings shall be submitted to the Board of Directors for the information, review and comment, if any.

Composition and attendance of Board Subcommittees for the year 2018

Name and retirement date	Directorship status	BAC	BHRRC	BNC	BIRMC	BCC	BITSC
Total minimum number of meetings to be held during the year as per statutory requirements		4	4	2	4	N/A	N/A
Total number of meetings held during the year		7	11	3	6	7	3
Mr Aswin De Silva Chairman (up to 12 November 2018)	NED/ NID	N/A	10, (Chairman w.e.f. 12 March 2015 – 12 November 2018)	N/A	N/A	7, (Chairman w.e.f. 03 February 2017 – 12 November 2018)	3, (Chairman w.e.f. 03 February 2017 – 12 November 2018)
Mr R M P Rathnayake Chairman (up to 19 February 2019)	NED/ NID	N/A	1, (Chairman w.e.f. 26 November 2018)	N/A	N/A	Chairman w.e.f. 26 November 2018	Chairman w.e.f. 26 November 2018
Mr D L P R Abeyaratne Ex officio Director (up to 11 July 2018)	NED/ NID	4, (Chairman w.e.f. 30 November 2015 – 11 July 2018)	4	2, (Chairman w.e.f. 03 February 2017 – 11 July 2018)	N/A	N/A	2
Mr A K Seneviratne Ex officio Director (up to 28 February 2019)	NED/ NID	4	N/A	3	6, (Chairman w.e.f. 30 November 2015)	N/A	N/A
Mr Anil Rajakaruna Senior Director (up to 31 December 2018)	NED/ NID	7	N/A	1, (Chairman w.e.f. 07 August 2018)	6	N/A	1
Ms Shehara Jayawardane Director (up to 12 November 2018)	NED/ NID	3, (Chairperson w.e.f. 07 August 2018 – 12 November 2018)	N/A	N/A	N/A	N/A	0
Dr D Shanmugasundaram Director	NED/ NID	3	4	N/A	N/A	N/A	N/A
Mr Ajith Pathirana Director (up to 19 July 2018)	NED/ NID	N/A	4	N/A	N/A	4	N/A
Mr U G R Ariyaratne Ex officio Director	NED/ ID	N/A	3	0	N/A	1	N/A
Mr Suranga Naullage Director (up to 31 December 2018)	NED/ NID	N/A	N/A	N/A	6	2	N/A
Mr Chandima Hemachandra Director (up to 19 July 2018)	NED/ NID	N/A	N/A	2	N/A	3	2

N/A = Not Applicable 0 = Required to be present but not attended

NED: Non-Executive Director ID: Independent Director NID: Non-Independent Director

Current Composition of the Board Subcommittees

Board Audit Committee (BAC)
Mr P Algama – Chairman
Mr Anil Rajakaruna – Member
Mr Nazri Nizar – Member

Board Integrated Risk Management Committee (BIRMC)
Mr P Algama – Chairman
Mr U G R Ariyaratne – Member
Dr D Shanmugasundaram – Member

Board Human Resources and Remunerations Committee (BHRRC)
Mr Jayaraja Chandrasekera – Chairman
Mr Anil Rajakaruna – Member
Mr Ajith Pathirana – Member

Board Nominations Committee (BNC)
Mr Anil Rajakaruna – Chairman
Mr U G R Ariyaratne – Member
Dr D Shanmugasundaram – Member

Board Credit Committee (BCC)
Mr Jayaraja Chandrasekera – Chairman
Mr Anil Rajakaruna – Member
Mr Ajith Pathirana – Member

Board IT Strategy Committee (BITSC)
Mr Jayaraja Chandrasekera – Chairman
Mr U G R Ariyaratne – Member
Mr Nazri Nizar – Member

Board Related Party Transaction Review Committee
Mr P Algama – Chairman
Mr Anil Rajakaruna – Member
Mr Ajith Pathirana – Member

Management committees

The Bank, in addition to the Board Subcommittees has appointed some Management committees based on Board-approved Committee Charters. The General Manager/CEO acts as the Chairman of all Management committees according to the Terms of Reference. The committees deliberate on critical matters relating to the operations of the Bank as described in the table below:

Management committee	Objective and responsibilities	Composition
Corporate Management Committee (CMC)	Oversee on matters relating to policy and strategy formulation, implementation of the policies and strategies at the operational level.	All officers serving the Bank in the capacity of Deputy General Manager and above.
Asset and Liability Management Committee (ALCO)	Maintaining the market and liquidity risk within the pre-determined risk appetite level in order to optimise the return	General Manager/CEO, Senior DGM, KMPs from the Divisions of Finance and Planning, Research and Development, International Operations, Credit, Treasury and Risk Management.
Investment Committee (IC)	Periodic review of Investment Policy of the Bank and oversee on the investment activities of the Bank within overall risk appetite level of the Bank.	General Manager/CEO, Senior DGM, KMPs from the Divisions of Finance and Planning, Research and Development, International Operations, Credit, Treasury, Legal and Risk Management.
Credit Committee (CC)	Periodic review of the Credit Policies of the Bank, implementation of the policies and engage in maintaining a healthy credit portfolio to optimise the returns within the risk appetite of the Bank.	General Manager/CEO, Senior DGM, KMPs from the Divisions of Finance and Planning, Research and Development, International Operations, Credit, Treasury, Legal and Risk Management.
Performance Review Committee (PRC)	Review of financial performance, progress of ongoing activities, withdrawal activities and any other support functions of the Bank that facilitates the performance.	General Manager/CEO, Senior DGM, all DGMs, all Consultant and Heads of Divisions, all AGMs, Compliance Officer and any other member appointed by the Committee.

Management committee	Objective and responsibilities	Composition
Branch Operations Steering Committee (BOSC)	Oversee the reinforcement of the branch operations within the delegated financial authority.	General Manager/CEO, Senior DGM, KMPs from the Divisions of Finance and Planning, Research and Development, Legal and Premises.
Operational Risk Management Committee (ORMC)	Manage operational risk of the Bank while overseeing on the implementation of the operational risk management technique and maintain the integrity of internal controls through taking relevant measures.	General Manager/CEO, Senior DGM, KMPs from the Divisions of Research and Development, Operations, Human Resource Development, Information Technology, Support Services, Premises, Legal, Risk Management, Compliance and Information Security.
Product Development Committee (PDC)	Oversee on long-term value creation through innovative products development to face the increasing competition.	General Manager/CEO, Senior DGM, KMPs from the Divisions of Research and Development, Operations, International, Information Technology, Retail Credit, Marketing, and Planning.
Human Resource Committee (HRC)	Development of human resources in line with the Bank's strategic objectives.	General Manager/CEO, Senior DGM, KMPs from the Divisions of Finance and Planning, Human Resource Development, Credit and Legal.
Marketing Committee (MKTC)	Provide with marketing advice, expertise and assistance to the Board and the Corporate Management, review and direct all aspects of marketing activities of the Bank	General Manager/CEO, Senior DGM, KMPs from the Divisions of Finance and Planning, Operations and Marketing.

Annual corporate governance report

The annual corporate governance compliance report of the Bank to be published as required by the Banking Act Direction No. 12 of 2007 is given on pages 157 to 173 and the compliance report on Code of Best Practices on Corporate Governance of CA Sri Lanka is given on pages 174 to 178.

During the year under review, the Bank is compliant with all the applicable laws, rules, regulations and codes on good corporate governance.

Roles and responsibilities of the Board

The powers and responsibilities of the Board are given in the Board Charter as listed below:

Powers reserved to the Board

- To act as the final decision-making authority with regard to any matter related to the Bank subject to restrictions made in the Board Charter or any other laws/regulations in force.
- To arrive at suitable decisions on financial matters subject to provisions of the approved Procurement Manual of the Bank and other applicable laws/regulations in force.
- To formulate policies and guidelines to govern all activities of the Bank in order to ensure that most favourable business initiatives are taken at all levels.
- To inquire into any matter pertaining to performance, management or administration of the Bank by way of calling for reports, appointment of a committee or any other suitable method as decided by the Board.

Responsibilities of the Board

- Engage in any macro level matter which requires direction/guidance from the Board of Directors.
- Maintaining regular monitoring and supervision over overall functions of the Bank.
- Taking appropriate actions based on recommendations made by any Board Subcommittee, any Director, General Manager/CEO or any other committee exercising powers delegated by the Board.
- Monitoring and evaluating the performance of the Bank and also performance of KMPs including General Manager/CEO.
- Appointment of General Manager/CEO and, placements and promotions in line with the Terms of Reference of BHRRC and BNC.

Board's role in risk management

The Board factors risk management as an integral part of the Bank's business strategy. Prudent oversight is rooted within the Board on risk management and the Board has established and delegated its responsibility to the BIRMC in discharging its duties in relation to the risk management function of the Bank. Accordingly, the Bank has formulated a strong Risk Management Framework, risk appetite limits and tolerance limits and mechanism to monitor the risk profile of the Bank. The Board monitors the risk profile of the Bank based on the reports submitted through BIRMC on a regular basis.

Roles of the Chairman and CEO

In line with the CBSL Directions and best practices of Corporate Governance, the role of Chairman and CEO are separate. The Chairman is a Non-Executive, Non-Independent Director while the General Manager/CEO is a KMP and not a member of the Board. The Board Charter clearly defines the roles and responsibilities of the Chairman and CEO.

The Chairman is responsible for providing the leadership to the Board, facilitating effective functioning of the Board, preserving order, and maintaining and promoting good corporate governance within the Bank as well as the Group. He ensures that the Board receives adequate information to make informed decisions in discharging its duties. He is also responsible for effective participation of members at the Board meetings and maintains open lines of communication with Key Management Personnel.

The General Manager/CEO is entrusted with execution of the Management function as directed by the Board and implementation of strategies as set out in the Strategic Business Plan. This includes long term as well as short to medium term strategies. The General Manager/CEO provides leadership to the Management team in carrying out day-to-day operations of the Bank in implementation of strategies. The General Manager/CEO ensures that good corporate governance and highest standards are applied and maintained when carrying out the affairs of the Bank.

Role of the Secretary to the Board of Directors

The Secretary to the Board has a key role to play in ensuring that the Board procedures are both followed and regularly reviewed to ensure good corporate governance within the Bank. The responsibilities of the Secretary to the Board is summarised below:

- Maintaining minutes of all meetings of the Board and its subcommittees.
- Ensure regulatory and statutory compliance by the Board of Directors.
- Ensure effective functioning of the Board.
- Provide professional advice to the Directors on relevant laws and regulations and also to ensure compliance with principles of corporate governance and other related regulatory framework.
- Ensure that the Board is well informed of the decisions made at the Board subcommittees and their outcomes.

The appointment and the removal of the Secretary to the Board is a matter involving the whole Board under the advice of BNC as it is a Key Management Personnel position.

Appointment and Re-election of Directors

Being a State-owned Bank, the appointment of Directors to the National Savings Bank is done as per the NSB Act No. 30 of 1971 and its amendments therein. The maximum period a Director can serve is restricted to nine years as per the provisions of the Banking Act Direction No. 12 of 2007 on Corporate Governance.

The re-election of Directors is also done as per the NSB Act No. 30 of 1971 and its amendments therein. The details of the Board of Directors and the changes that took place in the year 2018 are given on page 152.

Training of Directors

The Board of Directors of the Bank are provided with training through a Board Pack Solution which includes relevant statutes, circulars and other relevant documents on appointment. The Secretary to the Board will notify/convey the Board on any developments or changes to the structures. Directors participate the training/know how programmes organised by the regulator or any other authority.

Directors' remuneration and level and make up of remuneration

The remuneration of the Directors is determined by the relevant Minister. No Director is involved in determining his/her own remuneration. The Board Human Resource and Remuneration Committee (BHRRC) makes recommendations to the Board regarding the remuneration of the General Manager/CEO and the Key Management Personnel on the basis of collective agreement, which are reviewed once in three years. The Bank has put in place a Board approved Remuneration Policy for Key Management Personnel. Based on the recommendations by the BHRRC, the Board makes recommendations to the respective Minister responsible for state banks who grants final approval in accordance with the provisions of NSB Act and amendments therein. The BHRRC comprise three Non-Executive Directors.

Board and Board subcommittee evaluation

The Board and the Board Subcommittees annually conduct their own appraisals to ensure that the Board and the Board Sub Committees are discharging their duties according to the Board Charter and Board Sub Committee Charters which include the responsibilities outlined in the Banking Act Direction No. 12 of 2007 and other applicable rules and regulations as well as best practices on corporate governance. In the process of evaluation, each Director fills a Board Performance Evaluation Form which are submitted to the Board Nomination Committee by the Secretary to the Board.

Appraisal of CEO

The appraisal of the performance of General Manager/CEO is done on an annual basis by the BHRRC based on agreed criteria and inform the Board accordingly.

Annual Corporate Governance Report to be published in terms of Banking Act Direction No. 12 of 2007 and subsequent amendments therein

The Bank's adherence to the above Direction is set out as follows:

Section	Principles	Level of compliance in 2018
3 (1)	**The Responsibilities of the Board**	
3 (1) (i)	The Board shall strengthen the safety and soundness of the Bank, by ensuring the following:	
3 (1) (i) (a)	Approve and oversee the Bank's strategic objectives and corporate values and ensure that these are communicated throughout the Bank.	Complied with. The Bank's strategic objectives and corporate values are determined by the Board. These are incorporated in the Board-approved Strategic Business Plan for the period of 2018-2020 and communicated to all levels of employees.
3 (1) (i) (b)	Approve the overall business strategy of the Bank, the overall risk policy and risk management procedures and mechanisms with measurable goals, for at least the next three years.	Complied with. The Board-approved three-year strategic Business Plan (2018-2020) is implemented, which covers business strategy, directions and measurable goals. Strategic Business Plan is a rolling plan that is updated and reviewed annually. Strategic Business Plan (2019-2021) is approved by the Board in 2018. The Board has approved the risk management framework, mechanisms, policies, risk appetite and overall risk strategy of the Bank.
3 (1) (i) (c)	Identify the principal risks and ensure implementation of appropriate systems to manage the risks prudently.	Complied with. The BIRMC is entrusted by the Board for recommending the Bank's risk policy, identifying principal risks, setting governance structures and implementing systems to measure, monitor and manage the principal risks. The following reports provide an insight in this regard: → Risk Management Report on pages 194 to 226. → Board Integrated Risk Management Committee Report on pages 187 to 189.

Corporate Governance

Section	Principles	Level of compliance in 2018
3 (1) (i) (d)	Approve implementation of a policy of communication with all stakeholders, including depositors, borrowers, creditors, shareholders.	Complied with. The Bank has a Board-approved Communication Policy in place covering all stakeholders.
3 (1) (i) (e)	Review the adequacy and the integrity of the Bank's internal control systems and Management information systems.	Complied with. The BAC is assisting the Board with regard to the adequacy and integrity of the Bank's internal control system and Management information system. The Internal Audit Division and the Government Audit reviews on the same and those are reviewed by BAC and also the Management responses on the same.
3 (1) (i) (f)	Identify and designate Key Management Personnel, as defined in the International Accounting Standards.	Complied with. Appointment of all designated KMPs are done as recommended by the BNC.
3 (1) (i) (g)	Define the areas of authority and key responsibilities for Directors themselves and for Key Management Personnel (KMP).	Complied with. Areas of authority of the Board of Directors are governed by Section 7 of NSB Act. The Board Charter prepared in accordance with the NSB Act details the areas of authority and key responsibilities of the Board of Directors. Board Human Resources and Remuneration Committee has defined the areas of authority and key responsibilities for the Key Management Personnel.
3 (1) (i) (h)	Ensure that there is appropriate oversight of the affairs of the Bank by Key Management Personnel (KMP) that is consistent with Board policy.	Complied with. The Board subcommittees submit reports to the Board on financial reporting, internal control, risk management and other relevant matters delegated to those committees. Further, KMPs make regular presentation on the matters under their purview and are called by the Board to explain the matters under their purview.
3 (1) (i) (i)	Periodically assess the effectiveness of the Board of Directors' own governance practices, including: the selection, nomination and election of Directors and Key Management Personnel; the Management of conflicts of interests; and the determination of weaknesses and implementation of changes, where necessary.	Complied with. The Directors are appointed by the Minister in terms of Section 8 of NSB Act No. 30 of 1971 as amended by Act No. 28 of 1995. A self-evaluation of the performance of the Board is carried out annually assessing its own governance practices.
3 (1) (i) (j)	Ensure that the Bank has an appropriate succession plan for Key Management Personnel.	Complied with. A Board-approved succession plan for the KMPs is in place to ensure readiness and reviewed by the BNC in year 2018.
3 (1) (i) (k)	Meet regularly, on a need basis, with the Key Management Personnel to review policies, establish communication lines and monitor progress towards corporate objectives.	Complied with. KMPs are regularly involved in discussions at the meeting of Board and its subcommittees on progress towards performance, strategy, policy and other matters pertaining to their area of responsibility. Additionally, the Key Management Personnel make presentations on key items in the agenda under their purview and are called by the Board and its subcommittees in relation to the material matters with regard to policies and corporate objectives.
3 (1) (i) (l)	Understand the regulatory environment and ensure that the Bank maintains an effective relationship with regulators.	Complied with. The KMPs brief on the regulatory developments to the Board of Directors. Additionally, the Deputy General Manager (Audit), Compliance Officer and Chief Risk Officer brief the members of BAC and BIRMC on regulatory developments.

Section	Principles	Level of compliance in 2018
3 (1) (i) (m)	Exercise due diligence in the hiring and oversight of External Auditors.	Complied with. The Auditor General is the External Auditor of the Bank in terms of the provisions of Article 154 of the Constitution of the Democratic Socialist Republic of Sri Lanka and Section 37 in NSB Act as it is a State-owned bank. Further, the BAC is delegated with to review and monitor the independence, objectivity and the effectiveness of the audit process and make recommendations to Auditor General through Superintendent of Audit of any such external auditor appointed by the Auditor General to assist the Auditor General.
3 (1) (ii)	The Board shall appoint the Chairman and the Chief Executive Officer and define and approve the functions and responsibilities of the Chairman and the Chief Executive Officer in line with Direction 3 (5) of these Directions.	Complied with. Under the provisions of Section 11(1) of the NSB Act No. 30 of 1971 as amended by Act No.28 of 1995, the Chairman is appointed by the Minister. Section 26 (1) of the NSB Act states that the Board shall appoint a fit and proper person to be the General Manager of the Bank who shall be the Chief Executive Officer of the Bank. Chairman and CEO’s functions and responsibilities have been defined and approved by the Board. The responsibilities of Chairman and the CEO are separate and are defined and approved in line with the Section 3 (5) of this Direction which is given on page 156.
3 (1) (iii)	The Board shall meet regularly, and Board meetings shall be held at least twelve times a year at approximately monthly intervals. Such regular Board meetings shall normally involve active participation in person of a majority of Directors entitled to be present. Obtaining the Board’s consent through the circulation of written resolutions/papers shall be avoided as far as possible.	Complied with. Regular Board meetings are held each month with the active participation of Directors and the attendance at Board meetings is given on page 152 along with the number of meetings. The Bank has taken every measure to minimise obtaining the approval through circulation.
3 (1) (iv)	The Board shall ensure that arrangements are in place to enable all Directors to include matters and proposals in the agenda for regular Board meetings where such matters and proposals relate to the promotion of business and the management of risks of the Bank.	Complied with. The Board Calendar with tentative dates for Board and Subcommittee meetings for the following year is sent to all Members approximately one month before the end of the current year. The Chairman sets the Board agenda assisted by the Board Secretary. Directors may submit proposals for inclusion in the agenda on discussion with the Chairman
3 (1) (v)	The Board procedures shall ensure that notice of at least 7 days is given of a regular Board meeting to provide all Directors an opportunity to attend. For all other Board meetings, reasonable notice may be given.	Complied with. Notice of meetings along with the agenda and the Board Papers to be discussed are circulated seven days prior to the meeting to provide the Directors with additional time to attend on the matters and submit any urgent proposals.
3 (1) (vi)	The Board procedures shall ensure that a Director, who has not attended at least two-thirds of the meetings in the period of 12 months immediately preceding or has not attended the immediately preceding three consecutive meetings held, shall cease to be a Director.	Complied with. The Directors are appraised of their attendance in accordance with the Banking Act Direction No. 12 of 2007. Details of Directors’ attendance are given on page 152. No Director has been absent from two-thirds of the meetings in the immediately preceding 12 months or three consecutive meetings.

Corporate Governance

Section	Principles	Level of compliance in 2018
3 (1) (vii)	The Board shall appoint a Company Secretary who satisfies the provisions of Section 43 of the Banking Act No. 30 of 1988.	Complied with. The Secretary to the Board of National Savings Bank is an Attorney-at-Law that complies with the provisions of Section 43 of the Banking Act No. 30 of 1988. The Board Secretary is primarily responsible for handling secretariat work to the Board and the other functions specified in the statutes and other regulations.
3 (1) (viii)	All Directors shall have access to advice and services of the Company Secretary with a view to ensuring that Board procedures and all applicable rules and regulations are followed.	Complied with. All the Directors have the ability to obtain advices and services of the Secretary to the Board who is responsible for ensuring that the Board procedures are followed with and the applicable rules and regulations are complied with.
3 (1) (ix)	The Company Secretary shall maintain the minutes of Board meetings and such minutes shall be open for inspection at any reasonable time, on reasonable notice by any Director.	Complied with. The Secretary, National Savings Bank/Secretary to the Board maintains the minutes of the Board meetings and circulates them to the Board. The minutes are reviewed and approved at the next Board meeting. Additionally, the Directors have the access to the past Board papers and minutes through a secure electronic link.
3 (1) (x)	Minutes of Board meetings shall be recorded in sufficient detail so that it is possible to gather from the minutes, as to whether the Board acted with due care and prudence in performing its duties. The minutes shall also serve as a reference for regulatory and supervisory authorities to assess the depth of deliberations at the Board meetings. Therefore, the minutes of a Board meeting shall clearly contain or refer to the following: (a) a summary of data and information used by the Board in its deliberations; (b) the matters considered by the Board; (c) the fact-finding discussions and the issues of contention or dissent which may illustrate whether the Board was carrying out its duties with due care and prudence; (d) the testimonies and confirmations of relevant executives which indicate compliance with the Board's strategies and policies and adherence to relevant laws and regulations; (e) the Board's knowledge and understanding of the risks to which the Bank is exposed and an overview of the risk management measures adopted; and (f) the decisions and Board resolutions.	Complied with. Minutes of the meetings are kept covering the given criteria.

Section	Principles	Level of compliance in 2018
3 (1) (xi)	There shall be a procedure agreed by the Board to enable Directors, upon reasonable request, to seek independent professional advice in appropriate circumstances, at the Bank's expense. The Board shall resolve to provide separate independent professional advice to Directors to assist the relevant Director or Directors to discharge his/her/their duties to the Bank.	Complied with. Board Charter is in place, which enables the Directors upon reasonable request to seek independent professional advice in appropriate circumstances, at the Bank's expense.
3 (1) (xii)	Directors shall avoid conflicts of interests, or the appearance of conflicts of interest, in their activities with, and commitments to, other organisations or related parties.	Complied with. The Directors make declarations of their interests at appointment, annually and whenever there is a change. Directors are required to abstain from participating in the discussions, voicing their opinion or approving in situations where there is a conflict of interest and such Director is not counted in the quorum in such instances.
3 (1) (xiii)	The Board shall have a formal schedule of matters specifically reserved to it for decision to ensure that the direction and control of the Bank is firmly under its authority.	Complied with. The Board Charter details the powers reserved for the Board in discharging duties. Additionally, the Board has put in place systems and controls to facilitate discharging its duties.
3 (1) (xiv)	The Board shall, if it considers that the Bank is, or is likely to be, unable to meet its obligations or is about to become insolvent or is about to suspend payments due to depositors and other creditors, forthwith inform the Director of Bank Supervision of CBSL of the situation of the Bank prior to taking any decision or action.	Complied with. The Bank is solvent, and no such insolvent situation has arisen during the year.
3 (1)(xv)	The Board shall ensure that the Bank is capitalised at levels as required by the Monetary Board in terms of the capital adequacy ratio and other prudential grounds.	Complied with. The Board monitors capital adequacy and other prudential measures to ensure compliance with regulatory requirements and Bank's defined risk appetite. The Bank complies with the minimum capital requirements.
3 (1) (xvi)	The Board shall publish in the Bank's Annual Report, an Annual Corporate Governance report setting out the compliance with Direction 3 of these Directions.	Complied with. This report is part of Corporate Governance Report which is given on pages 148 in the Annual Report.
3 (1) (xvii)	The Board shall adopt a scheme of self-assessment to be undertaken by each Director annually and maintain records of such assessments.	Complied with. The Bank has adopted a scheme of self-assessment to be undertaken by every Director annually which is maintained by the Secretary to the Board. Additionally, every Director has carried out an assessment of "fit and propriety" to serve as a Director as per the CBSL Direction.
3 (2)	**Board's Composition**	
3 (2) (i)	The number of Directors on the Board shall not be less than 7 and not more than 13.	Complied with. As per Section 8 (1) of NSB Act the Board comprises seven Directors including the Chairman.

Corporate Governance

Section	Principles	Level of compliance in 2018
3 (2) (ii) (a)	The total period of service of a Director other than a Director who holds the position of Chief Executive Officer shall not exceed nine years.	Complied with. The period of Directors has been restricted to nine years and no Director at present has served the Bank more than nine years. The details of the appointments and tenor are given on page 152 of this Annual Report.
3 (2) (ii) (b)	A Director who has completed nine years as at 1 January 2008, or who completes such term at any time prior to 31 December 2008, may continue for a further maximum period of 3 years commencing 1 January 2009.	Not applicable.
3 (2) (iii)	An employee of a bank may be appointed, elected or nominated as a Director of the Bank (hereinafter referred to as an 'Executive Director') provided that the number of Executive Directors shall not exceed one-third of the number of Directors of the Board. In such an event, one of the Executive Directors shall be the Chief Executive Officer of the Bank.	Not applicable. The NSB Act does not include provisions to appoint Executive Directors.
3 (2) (iv)	The Board shall have at least three Independent Non-Executive Directors or one third of the total number of Directors, whichever is higher.	Directors are appointed by the Minister according to the Section 8 (1) (a) of the NSB Act. All seven Directors of the Bank are Non- Executive Directors as at 31 December 2018. However, the Board of Directors of the Bank includes one Independent Non-Executive Director and six Non-Independent and Non-Executive Directors. Please refer to Directors details on page 233 of the Annual Report of Board of Directors.
3 (2) (v)	In the event an alternate Director is appointed to represent an Independent Director, the person so appointed shall also meet the criteria that apply to the Independent Director.	Not Applicable.
3 (2) (vi)	Non-Executive Directors shall be persons with credible track records and/or have necessary skills and experience to bring an independent judgement to bear on issues of strategy, performance and resources.	Complied with.
3 (2) (vii)	A meeting of the Board shall not be duly constituted, although the number of Directors required to constitute the quorum at such meeting is present, unless more than one-half of the number of Directors present at such meeting are Non-Executive Directors.	Complied with. As per the NSB Act the quorum of the Board is 4 which is more than one-half of the Directors. All seven Directors of the Bank are Non-Executive Directors.
3 (2) (viii)	The Independent Non-Executive Directors shall be expressly identified as such in all corporate communications that disclose the names of Directors of the Bank.	Complied with. Please refer page 152

Section	Principles	Level of compliance in 2018
3 (2) (ix)	There shall be a formal, considered and transparent procedure for the appointment of new Directors to the Board. There shall also be procedures in place for the orderly succession of appointments to the Board.	Complied with. Appointments of Directors are carried out by the Minister as per the NSB Act under Section 8 (1) (a).
3 (2) (x)	All Directors appointed to fill a casual vacancy shall be subject to election by shareholders at the first general meeting after their appointment.	Not Applicable since the relevant subject Minister appoints them.
3 (2) (xi)	If a Director resigns or is removed from office, the Board shall: announce the Director's resignation or removal and the reasons for such removal or resignation; and issue a statement confirming whether or not there are any matters that need to be brought to the attention of shareholders.	Not Applicable. The Government of Sri Lanka, the sole shareholder of the Bank makes the appointments as well as removal of Directors through the Minister under whose purview the Bank falls in.
3 (2) (xii)	A Director or an employee of a bank shall not be appointed, elected or nominated as a Director of another bank except where such bank is a subsidiary company or an associate company of the first mentioned bank.	Not Applicable. Deputy General Manager (Finance and Planning), an employee of the Bank, has been appointed as a Director of Regional Development Bank (RDB) representing the shareholding of the NSB in line with the provisions of the Pradeshiya Sanwardana Bank Act No. 41 of 2008.
3 (3)	**Criteria to assess the fitness and propriety of Directors**	
3 (3) (i) (a), & (b)	The age of a person who serves as a Director shall not exceed 70 years.	Complied with. There are no Directors who are over 70 years of age.
3 (3) (ii)	A person shall not hold office as a director of more than 20 companies/entities/institutions inclusive of subsidiaries or associate companies of the Bank.	Complied with. No Director holds directorships of more than 20 companies/ entities/institutions inclusive of subsidiaries or associate companies of the Bank.
3 (4)	**Management functions delegated by the Board**	
3 (4) (i)	The Directors shall carefully study and clearly understand the delegation arrangements in place.	Complied with. The Board periodically reviews and approves the delegation arrangements of the Bank and ensures that the extent of delegation addresses the needs of the Bank whilst enabling the Board to discharge its functions effectively.
3 (4) (ii)	The Board shall not delegate any matters to a Board Committee, Chief Executive Officer, Executive Directors or Key Management Personnel, to an extent that such delegation would significantly hinder or reduce the ability of the Board as a whole to discharge its functions.	
3 (4) (iii)	The Board shall review the delegation processes in place on a periodic basis to ensure that they remain relevant to the needs of the Bank.	

Corporate Governance

Section	Principles	Level of compliance in 2018
3 (5)	**The Chairman and Chief Executive Officer**	
3 (5) (i)	The roles of Chairman and Chief Executive Officer shall be separated and shall not be performed by the same individual.	Complied with. The roles of Chairman and the CEO are performed by two separate individuals. A Board Charter is in place defining the responsibilities of the Chairman and the General Manager/ Chief Executive Officer.
3 (5) (ii)	The Chairman shall be a Non-Executive Director and preferably an Independent Director as well. In the case where the Chairman is not an Independent Director, the Board shall designate an Independent Director as the Senior Director with suitably documented terms of reference. The designation of the Senior Director shall be disclosed in the Bank's Annual Report.	Complied with. Chairman is a Non-Executive and Non-Independent Director. Board designated a Senior Director with the approval of Central Bank of Sri Lanka. However, there is no such requirement in the NSB Act to appoint a Senior Director. The details of the Senior Director is given on page 131 of this Annual Report.
3 (5) (iii)	The Board shall disclose in its corporate governance report, the identity of the Chairman and the Chief Executive Officer and the nature of any relationship	Complied with. The profiles of the members of the Board and General Manager/ CEO are available on pages 131 to 133 of this Annual Report. There is no material, financial, business or family relationships between the Chairman, General Manager and other members of the Board.
3 (5) (iv)	The Chairman shall: provide leadership to the Board; ensure that the Board works effectively and discharges its responsibilities; and ensure that all key and appropriate issues are discussed by the Board in a timely manner.	Complied with. The Chairman provides leadership to the Board and ensures that the Board functions effectively in discharging its responsibilities. The Board in a timely manner discusses all key issues.
3 (5) (v)	The Chairman shall be primarily responsible for drawing up and approving the agenda for each Board meeting,	Complied with. The Secretary to the Board draws up the agenda for the meetings in consultation with the Chairman.
3 (5) (vi)	The Chairman shall ensure that all Directors are properly briefed on issues arising at Board meetings and also ensure that Directors receive adequate information in a timely manner.	Complied with. Board meetings are scheduled well in advance and the relevant papers are generally circulated one week prior to the meeting through electronic means to ensure that the Directors are having sufficient time to review the papers and call for additional information and clarification, and after a meeting to follow up on issues consequent to the meeting.
3 (5) (vii)	The Chairman shall encourage all Directors to make a full and active contribution to the Board's affairs and take the lead to ensure that the Board acts in the best interests of the Bank.	Complied with. Evaluation of the role of the Chairman and the overall assessment of the Board's performance are incorporated in the Director's Self-evaluation Process.

Section	Principles	Level of compliance in 2018
3 (5) (viii)	The Chairman shall facilitate the effective contribution of Non-Executive Directors in particular and ensure constructive relations between Executive and Non-Executive Directors.	Complied with. The entire Board consists of Non-Executive Directors.
3 (5) (ix)	The Chairman shall not engage in activities involving direct supervision of Key Management Personnel or any other executive duties whatsoever.	Complied with. Chairman acts in Non-Executive capacity and he is not involved in executive functions to supervise KMPs.
3 (5) (x)	The Chairman shall ensure that appropriate steps are taken to maintain effective communication with shareholders and that the views of shareholders are communicated to the Board.	Complied with. The shareholder is being represented at the Board by the nominee of Secretary to Ministry of Treasury who is appointed as a Director by the provisions of the NSB Act.
3 (5) (xi)	The Chief Executive Officer shall function as the apex executive-in-charge of the day-to-day management of the Bank's operations and business.	Complied with.
3 (6)	**Board appointed Committees**	
3 (6) (i)	Each bank shall have at least four board committees as set out in Directions 3 (6) (ii), 3 (6) (iii), 3 (6) (iv) and 3 (6) (v) of these Directions. Each committee shall report directly to the Board. All committees shall appoint a secretary.	Complied with. Six Board committees are in place. Board Secretary acts as Secretary to all six committees. Board Audit Committee, Board Integrated Risk Management Committee, Board Human Resources and Remuneration Committee, Board Nominations Committee, Board Credit Committee and Board Information Technology Strategy Committee directly submit reports through the Chairmen of the respective Board committees to the Board.
3 (6) (ii)	**The following rules shall apply in relation to the Audit Committee:**	
3 (6) (ii) (a)	The Chairman of the Committee shall be an Independent Non-Executive Director who possesses qualifications and experience in accountancy and/or audit.	Not Applicable The Chairman of the Board Audit Committee is Non-Executive and Non-Independent. All the members of the Board appointed as per the NSB Act.
3 (6) (ii) (b)	All members of the Committee shall be Non-Executive Directors.	Complied with.
3 (6) (ii) (c)	The Committee shall make recommendations on matters in connection with: (i) the appointment of the External Auditor for audit services to be provided in compliance with the relevant statutes; (ii) the implementation of the Central Bank Guidelines issued to Auditors from time to time; (iii) the application of the relevant accounting standards; and	The Auditor General is appointed as per the NSB Act as the External Auditor of the Bank. And therefore, all the matters stated is taken into consideration. Therefore, complied with.

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Section	Principles	Level of compliance in 2018
	(iv) the service period, audit fee and any resignation or dismissal of the Auditor; provided that the engagement of the Audit partner shall not exceed five years, and that the particular Audit partner is not re-engaged for the audit before the expiry of three years from the date of the completion of the previous term.	Not Applicable since the Auditor General is the External Auditor of the Bank by Statute, the Committee has no role to play in the engagement of the External Auditor.
3 (6) (ii) (d)	The Committee shall review and monitor the External Auditor's independence and objectivity and the effectiveness of the audit processes in accordance with applicable standards and best practices.	Complied with. Since the Auditor General is the External Auditor the independence and objectivity are maintained. Effectiveness of the audit process is discussed with the Superintendent of the Government Audit at Board Audit Committee meetings.
3 (6) (ii) (e)	The Committee shall develop and implement a policy on the engagement of an External Auditor to provide non-audit services.	Not Applicable since the Auditor General is the External Auditor of the Bank. However, as per the BAC Charter, the Committee ensures that in the event the Auditor General appoints another External Auditor for assistance, it does not impair the firm's independence, objectivity or effectiveness.
3 (6) (ii) (f)	The Committee shall, before the audit commences, discuss and finalise with the External Auditors the nature and scope of the audit.	Not Applicable. The scope and the extent of audit have been determined by the Auditor General as the External Auditor.
3 (6) (ii) (g)	The Committee shall review the financial information of the Bank, in order to monitor the integrity of the Financial Statements of the Bank, its Annual Report, accounts and quarterly reports prepared for disclosure, and the significant financial reporting judgements contained therein.	Complied with. The Board Audit Committee has reviewed the quarterly Financial Statements and Annual Report of the Bank prepared for the disclosure purposes as and when ready for the publication. The Internal Audit Division submits a separate review report on the Financial Statements on each instance including the deviation in major judgemental areas, change in accounting policies etc. in the review report to the attention of Board Audit Committee.
3 (6) (ii) (h)	The Committee shall discuss issues, problems and reservations arising from the interim and final audits, and any matters the Auditor may wish to discuss including those matters.	Complied with. The BAC discusses issues, problems and reservations arising from the interim and final audits. The representatives of the Auditor General were present at the Committee meetings.
3 (6) (ii) (i)	The Committee shall review the External Auditor's management letter and the Management's response thereto.	Complied with. The Board Audit Committee reviews the External Auditor's Report issued under the Sections 14 (2) (c) and 13 (7) (a) of the Finance Act annually and the Management response thereon.

Section	Principles	Level of compliance in 2018
3 (6) (ii) (j)	The Committee shall take the following steps with regard to the internal audit function of the Bank:	
	i Review the adequacy of the scope, functions and resources of the internal audit department, and satisfy itself that the department has the necessary authority to carry out its work;	Complied with. The Annual Audit Plan prepared by the Internal Audit Division is submitted to the BAC for approval. This includes the scope, functions and resource requirements relating to the plan.
	ii Review the internal audit programme and results of the internal audit process and, where necessary, ensure that appropriate actions are taken on the recommendations of the internal audit department;	Complied with. The Committee reviews the internal audit plan and results of the internal audit procedures and ensures that appropriate actions are taken for improvements.
	iii Review any appraisal or assessment of the performance of the Head and senior staff members of the Internal Audit Department;	Complied with.
	iv Recommend any appointment or termination of the Head, senior staff members and outsourced service providers to the internal audit function;	Complied with. No such situation has arisen during the year.
	v. Ensure that the Committee is appraised of resignations of senior staff members of the Internal Audit Department; including the chief Internal Auditor and any outsourced service providers, and to provide an opportunity to the resigning senior staff members and outsourced service providers to submit reasons for resigning;	Complied with. No such situation has arisen during the year.
	vi. Ensure that the Internal Audit function is independent of the activities it audits and that it is performed with impartiality, proficiency and due professional care.	Complied with. According to the Governance Structure of the Bank, the Deputy General Manager (Audit) reports directly to the Board through BAC and is independent of any operations of the Bank.
3 (6) (ii) (k)	The Committee shall consider the major findings of internal investigations and Management's responses thereto;	Complied with. The Board Audit Committee has reviewed major findings and Management responses thereto. Please refer Committee Report on page 179.
3 (6) (ii) (l)	The Chief Finance Officer, the Chief Internal Auditor and a representative of the External Auditors may normally attend meetings. The Committee has had at least two meetings with the External Auditors without the Executive Directors being present.	Complied with. Seven meetings were held in the year of 2018 and a representative from Auditor General's Department was presented for five meetings. Deputy General Manager (Finance & Planning) and Deputy General Manager (Audit) normally attends meetings. All Directors are Non-Executive.

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Section	Principles	Level of compliance in 2018
3 (6) (ii) (m)	The Committee shall have: i. explicit authority to investigate into any matter within its terms of reference; ii. the resources which it need to do so; iii. full access to information; and iv. Authority to obtain external professional advice and to invite outsiders with relevant experience to attend, if necessary.	Complied with. As per the Board Audit Charter of the Bank, the Committee has been empowered to investigate any matter, resources to carry out its functions, access to information and authority to obtain professional advice. Refer Committee Report on page 179.
3 (6) (ii) (n)	The Committee shall meet regularly, with due notice of issues to be discussed and shall record its conclusions in discharging its duties and responsibilities.	Complied with. The Committee has met seven times during the year and minutes have been maintained. Members of the BAC are given due notice of issues to be discussed and the conclusions in discharging its duties and responsibilities.
3 (6) (ii) (o)	The Board shall disclose in an informative way:	Complied with. Please refer,
	i details of the activities of the Audit Committee;	Scope of Board Audit Committee is given in page 179.
	ii the number of Audit Committee meetings held in the year; and	Number of meetings held during the year are given in page 179.
	iii details of attendance of each individual Director at such meetings.	Details of attendance of Directors are given in page 179.
3 (6) (ii) (p)	The Secretary of the committee is the Company Secretary or the Head of the Internal Audit function and shall record and keep detailed minutes of the Committee meetings	Complied with. The Board Secretary is the Secretary and detailed minutes are maintained.
3 (6) (ii) (q)	The Committee shall review arrangements by which employees of the Bank may, in confidence, raise concerns about possible improprieties in financial reporting, internal control or other matters. Accordingly, the Committee shall ensure that proper arrangements are in place for the fair and independent investigation of such matters and for appropriate follow-up action and to act as the key representative body for overseeing the Bank's relations with the External Auditor.	Complied with. A Whistle-blower Policy is in place which covers these aspects and significant findings were reported to the Board Audit Committee for appropriate follow-up action. The Board Audit Committee is the key representative body for overseeing the Banks' relations with the External Auditor.
3 (6) (iii)	**The following rules shall apply in relation to the Human Resources and Remuneration Committee:**	
3 (6) (iii) (a)	The Committee shall determine the remuneration policy (salaries, allowances and other financial payments) relating to Directors, Chief Executive Officer (CEO) and Key Management Personnel of the Bank.	Complied with. Remuneration of the Directors is decided by the Ministry of Finance. The remuneration of the General Manager/CEO and KMPs is determined by the BHRRC based on the collective agreement and approved by the Board of the Bank.

Section	Principles	Level of compliance in 2018
3 (6) (iii) (b)	The Committee shall set goals and targets for the Directors, CEO and the Key Management Personnel.	Complied with. Not Applicable to Directors as all of them are Non-Executive and appointed by the Minister as per NSB Act. Goals and targets for General Manger/CEO and KMPs are set based on the Strategic Business Plan and linked to Key Performance Indicators.
3 (6) (iii) (c)	The Committee shall evaluate the performance of the CEO and Key Management Personnel against the set targets and goals periodically and determine the basis for revising remuneration, benefits and other payments of performance-based incentives.	Complied with. The Committee evaluated the performance of General Manager/ CEO and KMPs against the set targets and goals.
3 (6) (iii) (d)	The CEO shall be present at all meetings of the Committee, except when matters relating to the CEO are being discussed.	Complied with.
3 (6) (iv)	**The following rules shall apply in relation to the Nomination Committee:**	
3 (6) (iv) (a)	The Committee shall implement a procedure to select/appoint new Directors, CEO and Key Management Personnel.	Not Applicable. The Directors are appointed by the Minister as per the NSB Act. Section 11 – The Minster shall nominate one of the Directors of the Board to be its Chairman. Section 26 – The Board shall appoint a fit and proper person to be the General Manager of the Bank who shall be the Chief Executive Officer of the Bank. Appointment of KMPs is compiled with. Board of Directors appoints KMPs with the recommendation of Board Nomination Committee.
3 (6) (iv) (b)	The Committee shall consider and recommend (or not recommend) the re-election of current Directors.	Not Applicable. Directors are appointed by the Minister as per the NSB Act.
3 (6) (iv) (c)	The Committee shall set the criteria for eligibility to be considered for appointment or promotion to the post of CEO and the key management positions.	Complied with. The General Manager is appointed based on the accepted procedure with the approval of Board of Directors as per the NSB Act. The Board-approved promotion scheme is available which stipulates the attributes required to be eligible to or promoted to other Key Management Positions.
3 (6) (iv) (d)	The Committee shall ensure that Directors, CEO and Key Management Personnel are fit and proper persons to hold office as specified in the criteria given in Direction 3 (3) and as set out in the statutes.	Complied with. Signed affidavit and declarations of Directors and General Manager/CEO are obtained by the Board Secretary and the same are obtained from the KMPs by the Human Resource Development Division and forwarded to the Central Bank of Sri Lanka for assessing the fitness and propriety.

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Section	Principles	Level of compliance in 2018
3 (6) (iv) (e)	The Committee shall consider and recommend from time to time, the requirements of additional/new expertise and the succession arrangements for retiring Directors and Key Management Personnel.	Complied with. Appointment of the Chairman, Directors and the CEO are stipulated in the NSB Act. Appointments of KMPs are made by the Board of Directors based on the recommendations of BNC.
3 (6) (iv) (f)	The Committee shall be chaired by an Independent Director. The CEO may be present at meetings by invitation.	Not applicable. The Committee is chaired by the Senior Director.
3 (6) (v)	**The Board-Integrated Risk Management Committee:**	
3 (6) (v) (a)	The Committee shall consist of at least three Non-Executive Directors, Chief Executive Officer and Key Management Personnel supervising broad risk categories	Complied with. The Committee comprises of three Non-Executive Directors, General Manager/CEO and the Chief Risk Officer who is responsible for supervising broad risk categories.
3 (6) (v) (b)	The Committee shall assess all risks, i.e., credit, market, liquidity, operational and strategic risks to the Bank on a monthly basis through appropriate risk indicators and Management information. In the case of subsidiary companies and associate companies, risk management shall done, both on a bank basis and group basis	Complied with. The Board has approved the Policies on Credit Risk Management, Market and Liquidity Risk Management and Operational Risk Management on recommendation of the BIRMC. Risk Management Division (RMD) submits monthly risk reports to the Board and quarterly risk reports based on the Board-approved risk appetite through BIRMC.
3 (6) (v) (c)	The Committee shall review specific quantitative and qualitative risk limits for all management level committees such as the Credit Committee and the Asset Liability Committee and report any risk indicators periodically.	Complied with.
3 (6) (v) (d)	The Committee shall take prompt corrective action to mitigate the effects of specific risks.	Complied with. The Committee takes prompt corrective actions to mitigate the effects of specific risks in situations where such risk are beyond prudent levels decided by the Board on recommendation of the Committee based on the regulatory and policy level requirements.
3 (6) (v) (e)	The Committee shall meet at least quarterly to assess all aspects of risk management including updated Business Continuity Plans (BCP).	Complied with. During the year the, Committee had six meetings. Details of meetings and attendance are given on page 187.
3 (6) (v) (f)	The Committee shall take appropriate actions against the officers responsible for failure to identify specific risks and take prompt corrective actions as recommended by the Committee, and/or as directed by the Director of Bank Supervision.	Complied with. No necessities have arisen during the year.
3 (6) (v) (g)	The Committee shall submit a risk assessment report within a week of each meeting to the Board seeking the Board's views, concurrence and/or specific directions.	Complied with. The detailed minutes of the meetings are submitted to the next immediate Board meeting along with the recommendations and the Risk Management Reports.

Section	Principles	Level of compliance in 2018
3 (6) (v) (h)	The Committee shall establish a compliance function to assess the Bank's compliance with laws, regulations, regulatory guidelines, internal controls and approved policies on all areas of business operations. A dedicated compliance officer selected from Key Management Personnel shall carry out the compliance function and report to the Committee periodically.	Complied with. The Compliance function has been established to assess the Bank's compliance with laws, regulations, regulatory guidelines, internal controls and approved policies on areas of business operations. This function is headed by a dedicated Compliance Officer (CO). CO submits reports periodically to the BIRMC/BAC/Board.
3 (7)	**Related Party Transactions**	
3 (7) (i)	The Board shall take the necessary steps to avoid any conflicts of interest that may arise from any transaction of the Bank with any person,	Complied with. The Board-approved Related Party Transactions Policy is in place covering related parties, their transactions and restrictions on offering more favourable treatment to related parties in order to avoid any conflict of interest by the Board of Directors. Directors are requested to declare their related party transactions individually. These transactions are monitored through an automated system.
3 (7) (ii)	The type of transaction with related parties that shall be covered by this Direction.	Information in this regard is disclosed in Note 47 on "Related Party Disclosures".
3 (7) (iii)	The Board shall ensure that the Bank does not engage in transactions with related parties as defined in Direction 3 (7) (i) above, in a manner that would grant such parties "more favourable treatment" than that accorded to other constituents of the Bank carrying on the same business.	Complied with. Annual declarations are obtained from the Directors where such transactions would be identified. System is also developed to capture any transaction with "more favourable Treatment" than that accorded to other constituents of the Bank carrying on the same business and reported to the Board periodically. Transactions (if any) carried out with Related Parties in the normal course of business and disclosed in Note 47 to the Financial Statements "Related Party Disclosures" on page 337.
3 (7) (iv)	A bank shall not grant any accommodation to any of its Directors or to a close relation of such Director unless such accommodation is sanctioned at a meeting of its Board of Directors, with not less than two-thirds of the number of Directors other than the Director concerned, voting in favour of such accommodation.	Complied with. No such instances were recorded
3 (7) (v) (a)	Where any accommodation has been granted by a bank to a person or a close relation of a person or to any concern in which the person has a substantial interest, and such person is subsequently appointed as a Director of the Bank, steps shall be taken by the Bank to obtain the necessary security as may be approved for that purpose by the Monetary Board, within one year from the date of appointment of the person as a Director.	Complied with. No such instances were recorded

Corporate Governance

Section	Principles	Level of compliance in 2018
3 (7) (vi)	A bank shall not grant any accommodation or "more favourable treatment" other than on the basis of a scheme applicable to the employees of such bank.	Complied with. No such instances were recorded.
3 (7) (vii)	No accommodation granted by a bank under Direction 3 (7) (v) and 3 (7) (vi) above, nor any part of such accommodation, nor any interest due thereon shall be remitted without the prior approval of the Monetary Board and any remission without such approval shall be void and of no effect.	Complied with. No such instances were recorded.
3 (8) 3 (8) (i)	**Disclosures** The Board shall ensure that:	
3 (8) (i) (a)	Annual Audited Financial Statements and quarterly Financial Statements are prepared and published in accordance with the formats prescribed by the supervisory and regulatory authorities and applicable accounting standards, and that:	Complied with.
3 (8) (i) (b)	Such statements are published in the newspapers in an abridged form, in Sinhala, Tamil and English.	Complied with.
3 (8) (ii)	The Board shall ensure that the following minimum disclosures are made in the Annual Report:	
3 (8) (ii) (a)	A statement to the effect that the Annual Audited Financial Statements have been prepared in line with applicable accounting standards and regulatory requirements, inclusive of specific disclosures.	Complied with. Refer page 229 to 235 on Annual Report of Board of Directors and Statement of Directors' Responsibility for Financial Reporting on pages 236 to 237.
3 (8) (ii) (b)	A report by the Board on the Bank's internal control mechanism that confirms that the financial reporting system has been designed to provide reasonable assurance regarding the reliability of financial reporting, and that the preparation of Financial Statements for external purposes has been done in accordance with relevant accounting principles and regulatory requirements.	Complied with. Refer Directors' Statement on Internal Control over Financial Reporting on page 238 to 239 and Statement of Directors' Responsibility for Financial Reporting on pages 236 to 237.
3 (8) (ii) (c)	The External Auditor's certification on the effectiveness of the internal control mechanism referred to in Direction 3 (8) (ii) (b) above, in respect of any statements prepared or published after 31 December 2008.	Complied with. Refer Independent Assurance Report on Internal Controls on page 240.

Section	Principles	Level of compliance in 2018
3 (8) (ii) (d)	Details of Directors:	Complied with.
	i. including names, fitness and propriety;	Details of the Directors are given on page 152.
	ii. transactions with the Bank, and;	Refer Note 47 (d) to the Financial Statements on page 340.
	iii. the total of fees/remuneration paid by the Bank.	Refer Note 47 (d) to the Financial Statements on page 340.
3 (8) (ii) (e)	Total net accommodation as defined in 3 (7) (iii) granted to each category of related parties. The net accommodation granted to each category of related parties shall also be disclosed as a percentage of the Bank's regulatory capital.	Complied with. The net accommodations granted as a percentage of Bank's regulatory capital are given in Note 47 (e) to the Financial Statements on page 340.
3 (8) (ii) (f)	The aggregate values of remuneration paid by the Bank to its Key Management Personnel and the aggregate values of the transactions of the Bank with its Key Management Personnel, set out by broad categories such as remuneration.	Complied with. Details are given in Note 47 (d) to the Financial Statements on page 340.
3 (8) (ii) (g)	The External Auditor's certification of the compliance with these Directions in the annual corporate governance reports	Complied with. External Auditor's certification was obtained and set out on page 173 of this Annual Report.
3 (8) (ii)(h)	A report setting out details of the compliance with prudential requirements, regulations, laws, internal controls and measures taken to rectify any material non-compliance.	Complied with. Please refer Statement on Directors' Responsibility for financial reporting on page 236 to 237.
3 (8) (ii) (i)	A statement of the regulatory and supervisory concerns on lapses in the Bank's risk management, or non-compliance with these Directions that have been pointed out by the Director of Bank Supervision of CBSL if so directed by the Monetary Board to be disclosed to the public, together with the measures taken by the Bank to address such concerns.	Not Applicable. Monetary Board has not directed any disclosures to be made public during the year.
3 (9)	**Transitional and other general provisions**	Complied with. The Bank has complied with the applicable transitional provisions.

Compliance requirement of the Corporate Governance Direction No. 12 of 2007

The Auditor General has performed procedures in accordance with the principles set out in Sri Lanka Standards on Related Services 4,400 – Engagements to Perform Agreed – Upon Procedures Regarding Financial Information issued by The Institute of Charted Accountants of Sri Lanka to meet the compliance requirement of the Direction No. 12 of 2007 on Corporate Governance issued by the Central Bank of Sri Lanka. His findings given on his report dated 13 May 2019 were not materially different to the matters disclosed above and did not identify any significant inconsistencies to those reported above by the Board.

M A P Muhandiram
Secretary to the Board

Jayaraja Chandrasekara
Chairman

13 May 2019
Colombo

Compliance with the Code of Best Practice on Corporate Governance issued by the Institute of Chartered Accountants of Sri Lanka

Code reference	Principles	Level of compliance
A	**Directors**	
A.1	**The Board** The Board of National Savings Bank comprises seven Non-Executive Directors including the Chairman which is laid down in the National Savings Bank Act No. 30 of 1971 and the amendments therein. Five Directors of the Bank are appointed by the Minister as per the NSB Act and the two Ex-officio Directors; one shall be the Secretary to the Treasury or his nominee and the other shall be the Postmaster General or his nominee. The Board headed by the Chairman is the apex decision-making body of the Bank.	Complied
A.1.1	**Regular meetings** The Board has met regularly during the year by adhering to the statute. During the year, the Board has convened 17 meetings during the year. Complying with the respective charters, the Subcommittees met regularly during the year. The regularity of the Board meetings and the structure and process of submitting information had been agreed to and documented by the Board. Details of Board meetings and Subcommittee meetings are given on pages 152 to 153.	Complied
A.1.2	**Roles and Responsibilities of the Board** The Board Charter details the responsibilities entrusted to the Board which includes setting the strategic direction of the Bank, determining the risk appetite, financial reporting, compliance with laws and regulations, sound corporate governance, sustainable business development in corporate strategy and safeguarding the Bank. The Board appointed 06 Sub-Committees assisted the Board in discharging the responsibilities in the year 2018. The Board is assisted by the Secretary to the Board.	Complied
A.1.3	**The Board act in accordance with the laws of the country** The Board has an approved procedure in place to ensure that the Bank is in compliance with related laws, CBSL Directions and Guidelines and international best practices with regard to the operations. This includes procedures where by the Board can require the Bank to obtain independent professional advice and the expenses thereon are borne by the Bank.	Complied
A.1.4	**Access to advice and services of the Secretary and appointment or removal of the Secretary to the Board** All the Directors have the ability to obtain advices and services of the Secretary to the Board who is responsible for ensuring that the Board procedures are followed with and the applicable rules and regulations are complied with. The appointment and the removal of the Secretary to the Board is a matter involving the whole Board under the advice of BNC as it is a Key Management Personnel position. As per the Section 30 of NSB Act, no Director of the Bank shall be liable for any loss or damage suffered by the Bank unless such loss or damage was caused by his misconduct or wilful default.	Complied
A.1.5	**Independent judgement** The Board of Directors of the Bank has no vested interest and take independent decisions on matters relating to the Board including strategy, performance, resource allocation, risk management, compliance, and standards of conduct.	Complied
A.1.6	**Dedicate adequate time and effort to matters of the Board and the Company** Board meetings and Board Subcommittee meetings are scheduled well in advance and the relevant papers are generally circulated one week prior to the meeting through electronic means to ensure that the Directors are having sufficient time to review the papers and call for additional information and clarification, and after a meeting to follow up on issues consequent to the meeting. Given that, in exceptional situations there is a provision to circulate the papers closer to the meeting. This is supplemented by giving sufficient time to be familiarise with business operations, risks and controls.	Complied

Code reference	Principles	Level of compliance
A.1.7	**Calls for resolutions** As per the NSB Act, Chairman shall upon written requisition from any two Directors, call a special meeting of the Board where they feel it is in the best interest to the Bank to do so. In case of a special meeting, notice should be given to all Directors prior to four days of the meeting.	Complied
A.1.8	**Training of Directors** The Board of Directors of the Bank gets adequate training on appointment. Refer page 156 for details.	
A.2	**Division of responsibilities of Chairman and Chief Executive Officer (CEO)** The positions of the Chairman and the Chief Executive Officer have been separated in line with the best practices in order to maintain the balance of power and authority which is clearly defined in the Board Charter. Chairman of the Bank is a Non-Independent, Non-Executive Director while CEO is not a member of the Board.	Complied
A.3	**Chairman's role** The Chairman provides a leadership role in order to preserve good governance and facilitates the effective functioning of the Board. Chairman is responsible for maintaining open lines of communication with KMPs and contributes on strategic and operational matters. The agenda of the meeting is developed in consultation with General Manager/CEO, Directors and the Secretary to the Board, taking into consideration the matters relating to strategy, performance, resource allocation, risk management, and compliance. Sufficiently detailed information of matters included in agenda is provided to Directors in a timely manner. All Directors are made aware of their duties and responsibilities and Board Sub Committee Structures. All Directors are encouraged to make an effective contribution and obtain information necessary to discuss matters on the agenda and arrive at an informed decision. The views of Directors on issues under considerations are ascertained and recorded in minutes.	Complied
A.4	**Financial acumen** The Board possesses the required financial acumen and knowledge to offer guidance on matters relating to finance where some of the Directors being professionally qualified in fields of finance/accounting and/or having Senior Management positions and/or directorships.	Complied
A.5	**Board balance** The Board of the Bank comprises seven Non-Executive Directors appointed by the Minister in charge of State Banks who are appointed as per the NSB Act. The Board of Directors annually submit a signed and dated deceleration of their independence/non-independence.	Complied
A.6	**Supply of information** The Management provides appropriate and timely information to the Board generally, seven days prior to the Board meetings or Subcommittee meetings to discharge their duties and responsibilities effectively. Chairman ensures that the Board is adequately briefed on the matters discussed and the KMPs are requested to be present during the meetings to be present where deemed necessary. Any Director who is unable to attend a meeting is updated on proceedings through formally documented minutes of the meeting, prior to the next meeting which are discussed at the same. The agenda of the meetings and papers required, are generally circulated prior to seven days and the minutes of the previous meeting are generally circulated at least two weeks after the meeting.	Complied
A.7	**Appointments to the Board** As a state-owned bank, all Directors are appointed by the Minister in charge of the state banks according to the NSB Act. Refer section Corporate Governance on page 156 for details	Complied
A.8	**Re-election** As per the NSB Act, the term of a Directors is three years unless otherwise he vacates office early by death, resignation or removal of holding office. Refer Section Corporate Governance on page 156 for the details of Appointment and Re-election of Directors.	Complied

Corporate Governance

Code reference	Principles	Level of compliance
A.9	**Appraisal of Board performance** The Board annually assess their own performance to ensure that the Board is discharging their responsibilities satisfactorily. The evaluation process requires each Director to fill a Board Performance Evaluation Form. The responses are gathered and submitted to the Board Nomination Committee which will be submitted to the Board post review of Board Nomination Committee. The Board Subcommittee also follow the same procedure. Refer the section Corporate Governance on page 157 for details.	Complied
A.10	**Disclosure of information in respect of Directors** The information specified in the Code with regard to Directors are disclosed in this Annual Report as follows. Name, qualifications, expertise, material business interest and brief profiles are given on pages 131 to 133 Details of whether a Director is Executive, Non-Executive and/or Independent, Non-Independent are given on pages 152 to 153. Related party transactions are given on Note 47 (d) to the Financial Statements on page 340. Membership of Board Subcommittees and attendance at Board and Board Subcommittee are given on pages 152 to 154.	Complied
A.11	**Appraisal of Chief Executive Officer (CEO)/General Manager** Refer page 157.	Complied
B	**Directors' remuneration**	
B.1	In accordance with the NSB Act and its amendments therein, the Directors' remuneration is decided by the relevant Minister. No Director is involved in deciding his/her own remuneration. The Board Human Resource and Remuneration Committee (BHRRC) makes recommendations to the Board regarding the remuneration of the General Manager/CEO and the Key Management Personnel on the basis of collective agreements, which are reviewed once in three years. The Bank has put in place a Board-approved Remuneration Policy for Key Management Personnel. Based on the recommendations by the Committee, the Board makes recommendations to the respective Minister responsible for state banks who grants final approval in accordance with the provisions of NSB Act and amendments therein. The BHRRC comprise three Non-Executive Directors. Refer pages 183 to 184 on details of the Board Human Resource and Remuneration Committee.	Complied
B.2	**Level and make up of remuneration** As a state-owned Bank, the level and make up of remuneration is determined by the subject Minister according to the NSB Act.	Complied
B.3	**Disclosure of remuneration** Directors' remuneration and level and make up of remuneration on page 156. Details of Directors' total remuneration Refer Note 47 (d) to the Financial Statements on page 340. Members of the BHRRC and their Report – Refer pages 183 to 184.	Complied
C	**Relations with shareholder**	
C.1	**Constructive use of AGM and conduct of general meetings** As a state-owned Bank, NSB is conducting regular meetings with the subject Ministry.	Complied
C.2	**Communication with shareholder** The Government of Sri Lanka is the sole shareholder of the Bank. Therefore, this Annual Report is presented to the Parliament through the Ministry of Finance under whose purview the Bank comes in.	Complied

Code reference	Principles	Level of compliance
C.3	**Disclosure of major and material transactions** There were no "Major transactions" that would have materially affected the Bank's or the Group's net assets base, nor any material related party transactions except those disclosed in: Annual Report of Board of Directors on pages 229 to 235. Note 47 (d) to the Financial Statements on page 340.	Complied
D	**Accountability and audit**	
D.1	**Financial and business reporting (Annual Report)** This Annual Report presents a balanced and understandable review of the Bank's financial position, performance, business model, governance structure, risk management, internal controls, and challenges, opportunities and prospects. The Bank has taken all measures to ensure Annual Report including the financial statements as well as interim financial statements which are reviewed by BAC prior to publication are giving a true and fair view and has been prepared in accordance with the relevant laws and regulations. The Annual Report contains following disclosures which are required by the Code: → Management Discussion and Analysis – Refer pages 66 to 124. → Annual Report of the Board of Directors – Refer pages 229 to 235. → Statement of Directors' Responsibility for Financial Reporting – Refer pages 236 to 237. → Directors' Statement on Internal Controls – Refer pages 238 to 239. → General Manager/CEO's and Deputy General Manager's (Finance and Planning) Statement of Responsibility – Refer pages 243 to 244. → Related Party Transactions – Refer pages 339 to 341. The net assets value of the Bank is disclosed in Note 48 to the Financial Statements on page 341.	Complied
D.2	**Risk management and internal control** The Board is responsible for determining the risk appetite in achieving its strategic objectives, formulating and implementing appropriate processes of risk management and sound system of internal control to safeguard shareholder's investments and the assets of the Bank. The BIRMC assist the Board in discharging its duties with regard to risk management while BAC assist in discharging the Board's duties relating to processed and effectiveness of risk management and internal control. The summary of responsibilities of respective Committees are given under each Subcommittee Report. The Committees are formulated according to the Banking Act No. 12 of 2007 on Corporate Governance, Code of Best Practice on Corporate Governance issued by The Institute of Chartered Accountants of Sri Lanka and the Bank's policies. The BIRMC is supported by the Risk Management Division and pages 196 to 226 includes a comprehensive report on how the Bank is managing the risk.	Complied
D.3	**Audit Committee** The BAC comprises three Non-Executive Directors. The Senior Director of the Bank is a Member of the BAC. A summary of the scope of the BAC as per the Terms of Reference are given in the Report of BAC on pages 179 to 182 in the Annual Report. The Terms of Reference is prepared in accordance with the Code. Review of the Internal Controls are done by the Internal Audit Division and reports are regularly reported to the BAC. The external assurance on effectiveness of Internal Controls was obtained from the External Auditor, which is Auditor General and produced on page 240 in this Annual Report.	Complied
D.4	**Related Party Transactions Review Committee** The Bank has formed a Board-Related Party Transactions Review Committee for monitoring the related party transactions of Directors and KMPs in March 2019.	

Corporate Governance

Code reference	Principles	Level of compliance
D.5	**Code of business conduct and ethics** The Bank has Code of Business Conduct and Ethics that is internally developed and approved by the Board which applies to all employees of the Bank including KMPs. All officers of the Bank are required to furnish an annual asset liability declaration to the Human Resource Development Division. All the Directors furnish their annual assets and liability declaration to the relevant Ministry. The Bank has set applicable policies and procedures to identify and deal with any possible infringements. The Bank has put in place a Procurement Guidelines to ensure transparent procurement practices are applied.	Complied
D.6	**Corporate governance disclosures** The Directors are required to disclose the extent to which the Bank adheres to established principles and practices of good corporate governance. The following reports includes the Bank's compliance with the good governance principles and practices. The Corporate Governance Report from pages 148 to 173. Compliance with the Code of Best Practice on Corporate Governance issued by The Institute of Chartered Accountants of Sri Lanka on pages 174 to 178.	Complied
E & F	**Shareholder and other investors** The Bank is incorporated under an Act of Parliament, the NSB Act and the Government of Sri Lanka is the sole shareholder. The Bank is having regular and structured dialogue with the GOSL based on the mutual understanding of objectives through the subject Ministry as and when required.	Complied
G.	**Internet of things and cybersecurity** The Bank has a Board approved Information Security Policy (ISP) in place. The Bank has appointed a Chief Information Security Officer (CISO) who independently monitors and informs the Board on implementation and any exceptions if any with regard to cybersecurity risk management through BIRMC. Furthermore, Board Information Technology Strategy Committee appraises the Board on cyber risk management practices applied at the Bank and informs the Board accordingly. The Bank conducts four external and four internal vulnerability assessments each year.	Complied
H.	**Environment, Society and Governance (ESG)**	
H.1	**ESG Reporting** Sustainability business approach involves a holistic approach to value creation while embracing opportunities and managing risk. In its sustainability approach to the business, the Bank considers economic, social, and environmental values created through its strategy in the short, medium and long term. The sustainability reporting requires the Bank to recognise, measure and disclose and be accountable to internal and external stakeholders. Information required by the Code is given in the following sections of the Annual Report: → Management Discussion and Analysis – Refer pages 66 to 124. → Corporate Governance – Refer pages 148 to 178. → Stakeholders – Refer pages 54 to 59. → Materiality – Refer pages 60 to 64. → This Annual Report has been in accordance with IIRC Framework, and the GRI guidelines.	Complied

Report of the Board Audit Committee

Composition of the Committee

Board Audit Committee (BAC) consisted of following members during the year 2018.

Mr D L P R Abeyaratne, NE/NI – Chairman
(from 30 November 2015 to 11 July 2018)

Mr A K Seneviratne, NE/NI – Member
(from 4 June 2015 to 6 August 2018)

Mr Anil Rajakaruna, NE/NI – Member
(from 30 November 2015 to 31 December 2018)

Ms Shehara Jayawardane, NE/NI – Chairperson
(from 7 August 2018 to 12 November 2018)

Dr D Shanmugasundaram, NE/NI – Member
(from 7 August 2018)

(NE – Non-Executive, NI – Non-Independent,
I – Independent)

The details on current composition of the Committee and the profiles of the present members are given on pages 154 and 131 to 133 respectively.

The Board of Directors of the National Savings Bank which consists of seven Directors and being constituted under the provisions of Section 8 (1), its sub-section of NSB Act No. 30 of 1971 as amended, members of the Committee possess necessary qualifications, skills and experience to serve BAC.

Regular attendees by invitation

Deputy General Manager (Audit)
Deputy General Manager (Finance and Planning)

Secretary to the Committee

The Board Secretary functions as the Secretary to the Board Audit Committee as per the Board decision dated 11 July 2013.

Meetings

Name	Eligible to attend	Attended
Mr D L P R Abeyaratne	04	04
Mr A K Seneviratne	04	04
Mr Anil Rajakaruna	07	07
Ms Shehara Jayawardane	03	03
Dr D Shanmugasundaram	03	03

During the financial year ended December 31, 2018 the Committee held seven meetings and minimum quorum of the Committee is two-thirds as per the Charter of the BAC.

The Superintendent of Audit, Auditor General's Department as the representative of the Auditor General, attended five BAC meetings on invitation as an observer. The Senior Management including General Manager/CEO of the Bank participated the meetings by invitation on a need basis.

Charter of the Board Audit Committee

The Charter of the BAC has been approved by the Board of Directors and renewed regularly, clearly defines the Terms of Reference of the Committee. The Committee Charter was last reviewed in year 2018 by considering the new developments in the banking sector.

The Board Audit Committee (BAC) of the Bank was constituted in accordance with the Banking Act Direction No. 12 of 2007 on "Corporate Governance for Licensed Specialised Banks" issued by the Central Bank of Sri Lanka under Section 3 (6) (ii) and its subsequent amendments, provision of the Public Enterprises Guidelines for Good Governance and "Code of Best Practice on Corporate Governance" issued by The Institute of Chartered Accountants of Sri Lanka.

The Committee is empowered by the Board of Directors in discharging its responsibilities and fulfilling its oversight responsibilities for:

(a) The integrity of the Bank's Financial Statements;

(b) The effectiveness of the Bank's risk management function;

(c) The performance of the Bank's internal audit function; and

(d) The performance of the Bank's external audit function.

The Charter also stipulates the functions and responsibilities, and the authority of the Committee. The Charter Checklist was used to assist the Committee to assess its compliance to the Charter in performing Committee's functions and discharging its responsibilities.

Reporting

The Committee is directly reporting to the Board of Directors about its activities along with the minutes of the meetings. BAC provides Open Avenue of communication between internal audit, external audit and the Board of Directors. The Committee is of the view that Terms of Reference (TOR) of the Committee were complied within all material aspects.

Activities in 2018

Financial reporting

The Committee reviewed the Financial Statements of the Bank, in order to monitor the integrity of the Financial Statements and quarterly reports prepared for disclosure, and the significant financial reporting judgement contained therein prior to their release. The Committee shall focus on major judgment areas, any changes in accounting policies and practices, significant adjustments arising from the audit, the going concern assumption and compliance with relevant accounting standards and other legal requirements to evidence the Financial Statements give a true and fair view on financial position and performance of the Bank.

The Committee reviewed the "Report on the review of Financial Statement" for the year ended 2017 which was submitted along with findings by the Internal Audit Division and reviewed the draft Financial Statement submitted on quarterly basis.

Progress of Implementation of SLFRS 9

The Committee monitored on the impact assessment and implementation of SLFRS 9. The Committee reviewed the restated Financial Statements for comparative figures under SLFRS 9 which considered the first day impact arising due to implementation of SLFRS 9 and the Bank restated the Financial Statements as at 31 December 2017.

Implementation of Basel III

The Committee during the year reviewed the progress and compliance on the implementation of Banking Act Direction No. 1 of 2016 with regard to the capital and liquidity requirements. The Bank has fully-complied with requirements of the above-mentioned Direction as at December 2018.

Internal Capital Adequacy Assessment Process (ICAAP)

As per the Section 10 of the Banking Act Direction No. 1 of 2016 requires an independent review on the integrity, accuracy and reasonableness of the capital assessment process of the Bank. The Committee has reviewed the effectiveness of the internal control mechanism to meet the regulatory requirements on ICAAP.

Identification of risks and control measures

The Directors of the Bank and its subsidiary are responsible for identifying and evaluating risks and its impact on business operations and financial reporting. The Bank adapts risk-based audit approach and the Committee assessed the effectiveness of the Bank's internal control over financial reporting in line with the Banking Act Direction No. 12 of 2007, Section 3 (8) (ii) (b) and prepared based on the guidelines issued by The Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka).

BAC reviewed and assessed the Bank's risk management process, including the adequacy of the overall control environment and controls in areas of significant risks. Further, BAC reviewed and assessed the Bank's system of internal controls for detecting accounting and financial reporting errors and misappropriation of assets, legal violations, and non-compliance with the corporate code of conduct. In this regard, reviews the related findings and recommendations of the External and Internal Auditors, together with Management's responses.

The Directors' Statement on Internal Control and the Auditor General's Report on Internal Control are provided in pages 238 to 240. In this regard, the Committee is of the view that necessary procedures and checks are in place to provide reasonable assurance and the Bank is in compliance with the aforesaid requirements.

Internal audit and inspection

The BAC ensures that, the internal audit function is independent of the activities it audits. It reviewed the adequacy of the scope, functions and resources of the Internal Audit Division, and also satisfied itself that the Division had the necessary authority to carry out its work.

The Internal Audit Division of the Bank carried out audit of Branches, Divisions and other Units as per the Annual Audit Plan. The frequency of audit was determined by the level of risk assessed. The Audit Plan was approved by the BAC for implementation. The approved audit plan for the year 2018 has been achieved by the end of 2018.

The Internal Audit Division carried out audit checks to ensure compliance with policies and procedures and the effectiveness of the internal control systems and reports its findings in respect of any non-compliance. Audits were carried out to provide an independent and objective report on operational and management activities.

BAC reviewed findings of regular audit examinations and information system audits carried out by the Internal Audit Division. Further, the Committee reviewed the reports on internal investigations carried out during the period from November 2017 to November 2018, Report on Fraudulent Withdrawals of the Bank and reviewed the performance of senior staff members of the Audit and Vigilance Division for the year.

The Internal Audit Manual of the Bank summarises the operations of the internal audit function and delineates the policies, standards and procedures which will generally govern the internal audit function.

The Internal Audit Charter is used in order to assist the Internal Audit Division to discharge its duties effectively and independently. The Charter includes the scope, functions, responsibilities, authorities, reporting procedure, independence and objectivity of the Internal Audit Division.

External audit

By statute, the Auditor General is the External Auditor of the Bank. Meetings with the External Auditor, without Executive Management were held at least twice during the engagement. They were also provided with the opportunities of meeting the Committee independently, to discuss and express their views on any matter of significance.

Effectiveness of the audit process is discussed with the Superintendent of the Government Audit at BAC meetings. The Committee ensured the provision of all information and documents required by the External Auditor for the purpose of audit.

The Committee during the year,

- Reviewed the Report of the Auditor General that was submitted to the Parliament on the Financial Statements of the Bank for the year ended 31 December 2017, the Management Letter and the responses made thereon by the Corporate Management of the Bank and followed up the required corrective measures.
- Reviewed and discussed the significant reports submitted by the Auditor General's Department where deemed necessary actions were initiated.

Monitoring of internal controls

- Follow-up mechanism for rectification of issues identified during audits have been strengthened
- Periodical review of reports on disciplinary matters and investigations
- Review of common instances of frauds/irregularities in order to take initiatives to avoid recurrence
- Directions to expedite investigations/disciplinary inquires

Ethics and good governance

The Committee continuously reviewed and emphasised on endurance of good Corporate Governance practices in the Bank.

In this regard, the Fraud Risk Management and Whistle-blowing Policy of the National Savings Bank are key element for safeguarding the Bank's integrity. It is aimed at enhancing the Bank's transparency and underpinning its system for combating practices that might damage its activities and reputation and provide a means for early detection of fraud and other problematic situations.

The BAC reviewed on a quarterly basis all the cases of frauds. During the quarterly review, the BAC scrutinised statistical information as well as details of each fraud, action taken thereon and issue directions on the punitive and preventive aspects of frauds, where necessary.
The BAC had the right to, at any time; request a briefing regarding any preliminary investigation and findings.

Sri Lanka Accounting Standards

The Committee reviewed and revised the decisions on adoption of new and revised Sri Lanka Accounting Standards (LKASs)/Sri Lanka Financial Reporting Standards (SLFRSs) applicable to the Bank and made required recommendations therein.

Compliance

The Committee reviewed the effectiveness of the system for monitoring compliance with laws and regulations and the results of Management's investigation and follow-up (including disciplinary action) of any instances of non-compliance.

Report of the Board Audit Committee

Focus for 2019 and beyond

- Continue to focus on financial systems, processes, internal controls used by the Bank are responding to the complex requirements of the external and internal environment and operating effectively.
- Monitoring and making required developments based on the independent reviews of the Auditor General through assessing the impacts to the Bank.

Committee evaluation

The Committee completed the evaluation process with self-assessment for the year 2018 and concluded that its performance was effective where the results of evaluation were communicated to the Board.

A K Seneviratne
Chairman
Board Audit Committee

14 March 2019
Colombo

Board Audit Committee

Strategic objectives	**Stakeholders**	**Material risks**
Promoting organic growth	Shareholder	Credit risk
Leading by example	Regulators and Government Institutions	Market risk
Reinforcing risk culture	Customers	Operational risk
		Liquidity risk
		Compliance risk
		Strategic risk
		Reputational risk
		Cybersecurity risk
Refer pages 40 to 50 for more details.	Refer pages 54 to 59 for more details.	Refer page 140 for more details.

Report of the Board Human Resource and Remuneration Committee

Composition of the Committee

The Board-appointed Human Resources and Remuneration Committee (BHRRC) comprised three Non-Executive Directors as at 31 December 2018. BHRRC consisted of following members during the year 2018.

Mr R M P Rathnayake – Chairman NE/NI
(from 26 November 2018 to 19 February 2019)

Mr Aswin De Silva, NE/NI – Chairman
(from 12 March 2015 to 12 November 2018)

Mr D L P R Abeyaratne, NE/NI – Member
(from 12 March 2015 to 11 July 2018)

Mr Ajith Pathirana, NE/NI – Member
(from 30 November 2015 to 19 July 2018)

Dr D Shanmugasundaram, NE/NI – Member
(from 7 August 2018)

Mr U G R Ariyaratne, NE/I – Member
(from 31 August 2018)

(NE – Non-Executive, NI – Non-Independent, I – Independent)

The details on current composition of the Committee and the profiles of the present members are given on page 154 and 131 to 133 respectively.

Regular attendees by invitation

The General Manager/CEO provides information to the Committee and attends all meetings of the Committee, except when matters relating to the General Manager/CEO are being discussed.

The Assistant General Manager (Human Resource Development) and Senior Management of the Bank participated the meetings by invitation on a need basis.

Secretary to the Committee

The Secretary to the Board, functions as the Secretary to the BHRRC.

Meetings

The Committee meetings are held quarterly however based on the needs, meetings are being fixed accordingly. Eleven (11) meetings were held during the year 2018 and minimum quorum of the Committee is two-thirds as per the Charter of the BHRRC. Attendance of the Committee members during the year are as follows:

Name	Eligible to attend	Attended
Mr Aswin De Silva	10	10
Mr R M P Rathnayake	01	01
Mr D L P R Abeyaratne	05	04
Mr Ajith Pathirana	06	04
Mr U G R Ariyaratne	05	03
Dr D Shanmugasundaram	05	04

Charter of the BHRRC

The Board Human Resource and Remuneration Committee (BHRRC) constituted in terms of the provisions of Section 3 (6) (i) and (iii) of Banking Act Direction No. 12 of 2007 issued by the Monetary Board of the Central Bank of Sri Lanka (CBSL) under Section 76 J (1) of the Banking Act No. 30 of 1988, as amended. The Committee reports directly to the Board of Directors and the proceedings of Committee meetings have been regularly reported to the Board of Directors.

The Role and Responsibilities of the Committee as per the Charter includes the followings:

The Committee is responsible for determining the remuneration policy (salaries, allowances and other financial payments) relating to the General Manager/CEO and Key Management Personnel of the Bank other than the remunerations determined by the Collective Agreement.

Report of the Board Human Resource and Remuneration Committee

The Committee set goals and targets for General Manager/CEO and the Key Management Personnel. Further, evaluated the performance of the General Manager/CEO and Key Management Personnel against the set targets and goals periodically and determine the basis for revising remuneration, benefits and other payments of performance-based incentives.

The Committee reviewed all significant Human Resource Policies, initiatives, salary structures besides terms and conditions relating to staff at senior executive level. In this process, necessary information and recommendations were obtained from the General Manager/CEO and the Senior Management of the Bank.

Activities during the year 2018

Important activities attended and carried out by the Committee during the year 2018 were as follows:

- Review of the Human Resources Policy and the Disciplinary Code of the Bank
- Evaluation of Key Performance Indicators (KPI) of Key Management Personnel (KMPs) for 2017 (General Manager/CEO, Senior DGM, all DGMM, all Consultants, and all AGMM except Chief Risk Officer and Compliance Officer).
- Reviewed the recruitment, promotion and upgrading of staff based on the requirement of the Bank.
- Reviewed changes of designations from non-Banking to Banking stream and vice versa.
- Revisited and provided a value addition to staff welfare benefit scheme of the Bank.
- Consideration of appeals submitted by staff on HR-related matters.
- Reviewed the effect of punishment on staff promotions.
- Review of Scheme of Recruitment.
- Recruitment of Trainees.

Focus for 2019 and beyond

- Continue to assure the Bank is maintaining the relevance of Remuneration Policy.
- Continue to focus on development of human resource strategy to inculcate an engaged employee culture.
- Meeting the responsibilities of the Charter.

Committee evaluation

The Committee completed the evaluation process with self-assessment for the year 2018 and concluded that its performance was effective where the results of evaluation were communicated to the Board.

R M P Rathnayke
Chairman
Board Human Resources and Remuneration Committee

14 March 2019
Colombo

Board Human Resource and Remuneration Committee

Strategic objectives	Stakeholders	Material risks
Heightening customer experience	Customers	Strategic risk
Enhancing employee engagement	Employees	Operational risk
Leading by example	Shareholders	Reputational risk
Promoting organic growth	Regulators and Government Institutions	
Reinforcing risk culture		
Refer pages 40 to 50 for more details.	Refer pages 54 to 59 for more details.	Refer page 140 for more details.

Report of the Board Nomination Committee

Composition of the Committee

The Board-appointed Nomination Committee (BNC) comprised three Non-Executive Directors as at 31 December 2018.

The following Directors functioned as members of BNC during the year 2018.

Mr Anil Rajakaruna, NE/NI – Chairman
(From 7 August 2018 to 31 December 2018)

Mr D L P R Abeyaratne, NE/NI – Chairman
(From 3 February 2017 to 11 July 2018)

Mr A K Seneviratne, NE/NI – Member
(From 3 February 2017 to 28 February 2019)

Mr Chandima Hemachandra, NE/NI – Member
(From 18 January 2018 to 19 July 2018)

Mr U G R Ariyaratne, NE/I – Member
(From 31 August 2018)

(NE – Non-Executive, NI – Non-Independent, I – Independent)

The details on current composition of the Committee and the profiles of the present members are given on page 154 and 131 to 133 respectively.

Regular attendees by invitation

The General Manager/CEO provides information to the Committee and attends meetings of the Committee on invitation.

Secretary to the Committee

The Secretary to the Board, functions as the Secretary to the BNC also.

Meetings

During the financial year ended 31 December 2018, three Board Nomination Committee meetings were held and minimum quorum of the Committee is two-thirds as per the charter of the BNC.

Attendance of the Committee members during the year are as follows:

Name	Eligible to attend	Attended
Mr Anil Rajakaruna	01	01
Mr D L P R Abeyaratne	02	02
Mr A K Seneviratne	03	03
Mr Chandima Hemachandra	02	02
Mr U G R Ariyaratne	01	–

Charter of the Committee

The Board of Directors has established the Board Nomination Committee (BNC) in compliance with the Banking Act Direction No. 12 of 2007, Corporate Governance for Licensed Specialised Banks in Sri Lanka issued by the Monetary Board of the Central Bank of Sri Lanka under Section 76 J (1) of the Banking Act No. 30 of 1988 as amended, to ensure Board oversight and control over selection of Key Management Personnel.

Role and responsibilities of the Committee:

The Board Nomination Committee is responsible for implementing a procedure to select/appoint General Manager/CEO and Key Management Personnel, setting out criteria such as qualifications, experience and key attributes required for eligibility to be considered for appointment or promotion to the post of General Manager/CEO and the Key Management Positions.

Report of the Board Nomination Committee

Further, the Committee shall ensure that the Directors, General Manager/CEO and Key Management Personnel are fit and proper persons to hold office specified in the criteria given in Direction 3 (3) and as set out in the Statutes. The Committee shall also consider and recommend from time to time, the requirements of additional/new expertise and succession arrangements for retiring Key Management Personnel.

Activities during the year 2018

Important activities attended and carried out by the Committee during the year were as follows:

- Review and approval for proposed Cadre for the Bank – 2018
- Review the Succession Plan of the Bank.
- Interviews for posts of Special Grades in banking and non-banking streams, and Key Management Personnel (KMPs) (initiate interviews for posts of Assistant General Managers – Special Grade)
- Evaluation of Directors' Self-assessment Scheme

Focus for 2019 and beyond

- Continuous monitoring of review on matters relating to KMPs and adherence to the compliance on regulatory requirements.
- Continuous monitoring of the succession plan and the Bank's adherence.
- Meeting the responsibilities of the Charter.

Committee evaluation

The Committee completed the evaluation process with self-assessment for the year 2018 and concluded that its performance was effective, where the results of the evaluation were communicated to the Board.

Anil Rajakaruna
Chairman
Board Nomination Committee

14 March 2019
Colombo

Board Nomination Committee

Strategic objectives	Stakeholders	Material risks
Promoting organic growth	Shareholders	Strategic risk
Leading by example	Regulators and Government Institutions	Reputational risk
Reinforcing risk culture		Compliance risk
Refer pages 40 to 50 for more details.	Refer pages 54 to 59 for more details.	Refer page 140 for more details.

Report of the Board Integrated Risk Management Committee

Composition of the Committee

The Board appointed Integrated Risk Management Committee (BIRMC) comprised three Non-Executive Directors.

The following members functioned as members of BIRMC for the year 2018:

Board members

Mr A K Seneviratne, NE/NI – Chairman
(From 30 November 2015 to 28 February 2019)

Mr Suranga Naullage, NE/NI – Member
(From 30 November 2015 to 31 December 2018)

Mr Anil Rajakaruna, NE/NI – Member
(From 14 August 2017 to 31 December 2018)

(NE – Non-Executive, NI – Non-Independent,
I – Independent)

Non-Board members

General Manager/CEO

Chief Risk Officer

The details on current composition of the BIRMC and the profiles of the present Board members are given on page 154 and 131 to 133 respectively.

Attendees by invitation

The Committee requested other DGMs, AGMs, Compliance Officer, and Chief Managers to be present at the meetings as and when required.

Secretary to the Committee

The Secretary to the Board, functions as the Secretary to the BIRMC.

Meetings

BIRMC meets on a quarterly basis however based on the needs, meetings are being fixed accordingly. During the year 2018, BIRMC convened six meetings and minimum quorum of the Committee is two-thirds as per the Charter of the BIRMC.

Attendance of the Committee members during the year are as follows:

Name	Eligible to attend	Attended
Mr A K Seneviratne	06	06
Mr Suranga Naullage	06	06
Mr Anil Rajakaruna	06	06

Charter of the Committee

The Board of Directors has established the Board Integrated Risk Management Committee (BIRMC) in compliance with the Banking Act Direction No. 12 of 2007, Corporate Governance for Licensed Specialised Banks in Sri Lanka, issued by the Monetary Board of Central Bank of Sri Lanka under the power vested in the Monetary Board, in terms of the Banking Act No. 30 of 1988.

The Terms of Reference set out by the Board of Directors, includes the following:

- To assist the Board of Directors in fulfilling its responsibilities relating to risk management and establishing an effective risk management framework.
- To implement the Integrated Risk Management Policy and other risk-related policies approved by the Bank and periodic updating of the Bank-wide risk management framework.
- Ensure that all credit, market, operational and strategic risks faced by the Bank are identified, measured, monitored, and managed adequately.
- To work with Key Management Personnel very closely on all critical risk areas and make suitable recommendation to the Board within the framework of the authority and responsibility assigned to the Committee.

Report of the Board Integrated Risk Management Committee

- Identify, review, report and recommend on risk of new operational developments and compliance related to those concerns.
- Review implementation and compliance with the Basel III Directions issued by CBSL.

During the year 2018, the BIRMC has reviewed the Charter. The Committee reviews policies, reports and proposals on risk and compliance related to the Bank. BIRMC grants approval for proposals within its mandate and recommends proposals/reports to the Board of Directors which required to be scrutinised by the Board.

Respective chapter/segment on risk management presents detailed introduction over risk management functions of the Bank and its significance. BIRMC is supported by Risk Management, Compliance Divisions and other operational divisions in discharging its responsibilities.

Activities during the year 2018

The Committee assesses all main risks such as operational, credit, market, liquidity etc., which can adversely affect to the Bank. It maintains close relationship with the Key Management Personnel and the Board to fulfil its statutory, fiduciary and regulatory responsibilities for risk management.

Effectiveness of the risk management process is annually audited by the Internal Audit Division of the Bank.

Important activities attended and carried out by the Committee during the year were as follows:

- Review of reports on Risk appetite of the Bank, tolerance limits and other reports highlighting different aspects of risk of the Bank (i.e., credit risk, market risk, operational risk, liquidity risk, HR risk, technical risk, cybersecurity risk etc.)
- Review of different risk limits and grant necessary approvals.
- Reviews of adequacy of measures and standards maintained by the Bank to meet internationally-recognised norms in the industry, regulations/guidelines of the regulator – Central Bank of Sri Lanka and Internal Capital Adequacy Assessment Process (ICAAP) in line with audit concerns on ICAAP document.
- Follow-up progress of rectification process of supervisory concerns raised by the Central Bank of Sri Lanka at their examination.
- Reviewed periodic reports on related party transactions, key issues of the Bank such as financial frauds, Fraud Risk Management – Whistle-blowing Policy.
- Review of compliance assessments on Bank and its core functions such as pawning, credit, human resource management, maintaining KYC (Know Your Customer) requirement etc.
- Continuous monitoring and review over status of Banks compliance with Basel III standards.
- Annual review of Compliance Programme and Compliance Manual.

Focus for 2019 and beyond

- Continue to focus on macro and microenvironmental factors, markets, local and international risk factors.
- Continuous oversight on the implementation of risk and compliance strategy of the Bank.
- Assessment of the local as well as international trends in the area of risk management.
- Continuous oversight on being a cyber resilient bank in the journey towards digitalisation.
- Continue to focus on evolving regulatory requirements according to the trends in the market and the Bank's approach to risk management and compliance.

Committee evaluation

The Committee completed the evaluation process with self-assessment for the year 2018 and concluded that its performance was effective, where the results of the evaluation were communicated to the Board.

A K Seneviratne
Chairman
Board Integrated Risk Management Committee

14 March 2019
Colombo

Board Integrated Risk Management Committee

Strategic objectives	Stakeholders	Material risks
Heightening customer experience	Customers	Credit risk
Enhancing employee engagement	Employees	Market risk
Reinforcing risk culture	Shareholders	Operational risk
Promoting organic growth	Regulators and Government Institutions	Liquidity risk
Leading by example	Business partners	Compliance risk
	Society and Environment	Reputational risk
		Strategic risk
		Cybersecurity risk
		Contingent risk
		Model risk
Refer pages 40 to 50 for more details.	Refer pages 54 to 59 for more details.	Refer page 140 for more details.

Report of the Board Credit Committee

Composition of the Committee

The Board Credit Committee comprised three Non-Executive Directors as at 31 December 2018.

The following Directors functioned as members of Board Credit Committee during the year 2018:

Mr R M P Rathnayake, NE/NI – Chairman
(from 26 November 2018 to 19 February 2019)

Mr Aswin De Silva, NE/NI – Chairman
(from 3 February 2017 to 12 November 2018)

Mr Chandima Hemachnadra, NE/NI – Member
(from 3 February 2017 to 19 July 2018)

Mr Ajith Pathirana, NE/NI – Member
(from 14 August 2017 to 19 July 2018)

Mr Suranga Naullage, NE/NI – Member
(from 7 August 2018 to 31 December 2018)

Mr U G R Ariyaratne, NE/I – Member
(from 31 August 2018)

(NE – Non-Executive, NI – Non-Independent,
I – Independent)

The details on current composition of the Committee and the profiles of the present members are given on page 154 and 131 to 133 respectively.

Regular attendees by invitation

General Manager/CEO, DGM (Credit) and DGM (Retail Credit) attended meetings during the year as invitees.

Secretary to the Committee

The Secretary to the Board, functions as the Secretary to the BCC.

Meetings

During the financial year ended 31 December 2018 seven Board Credit Committee meetings were held. The quorum for a meeting is two members.

Attendance of the Committee members during the year are as follows:

Name	Eligible to attend	Attended
Mr Aswin De Silva	07	07
Mr Chandima Hemachandra	05	03
Mr Ajith Pathirana	05	04
Mr Suranga Naullage	02	02
Mr U G R Ariyaratne	01	01

Charter of the Committee

The Board of Directors has established the Board Credit Committee (BCC) in compliance with the Banking Act Direction No. 12 of 2007, Corporate Governance for Licensed Specialised Banks in Sri Lanka issued by the Monetary Board of the Central Bank of Sri Lanka under Section 76 J (1) of the Banking Act No. 30 of 1988 as amended and National Savings Bank Act No. 30 of 1971 as amended, to conduct periodic reviews on the Credit Policy and Investment Policy of the Bank as and when required, and to engage in approving of credit facilities and investments within the limits delegated to.

Roles and responsibilities of the Committee

Reviews and recommends the Banks strategic objectives with respect to credit and investment including policies, procedures and other related policy level documents.

Assists the Board of Directors through efficient and effective management relating to Credit Policy and Investment Policy of the Bank in order to promote and reinforce a sound, robust and healthy credit risk acceptance and management culture.

Approves and advises on the pricing of Loans and Advances and Investments in accordance with the recommendations by Assets and Liability Management Committee (ALCO).

Ensures implementation of appropriate systems to manage risks and strengthen internal controls and Management Information Systems with respect to credit aspect of the Bank.

Activities during the year 2018

The Committee approved the credit and investment proposals and other specific reports which prerequisite the approval of the Board in line with the lending and investment policies and credit risk appetite of the Bank in order to ensure the efficient and effective performance over the credit and investment direction of the Bank.

Focus for 2019 and beyond

- Maintaining a healthy credit book and investment book while enabling the risk appetite.
- Proactive risk management, strengthen internal controls and management information systems with respect to credit aspects of the Bank.
- Continuous monitoring on the adherence to Board-approved limits

Committee evaluation

The Committee completed the evaluation process with self-assessment for the year 2018 and concluded that its performance was effective, where the results of the evaluation were communicated to the Board.

R M P Rathnayake
Chairman
Board Credit Committee

14 March 2019
Colombo

Board Credit Committee

Strategic objectives	Stakeholders	Material risks
Heightening customer experience	Customers	Strategic risk
Promoting organic growth	Shareholders	Credit risk
Leading by example	Regulators and Government Institutions	Compliance risk
Reinforcing risk culture		
Refer pages 40 to 50 for more details.	Refer pages 54 to 59 for more details.	Refer page 140 for more details.

Report of the Board Information Technology Strategy Committee

Composition of the committee

The Board Information Technology Strategy Committee (BITSC) comprised three Non-Executive Directors as at 31 December 2018.

The following Directors functioned as members of BITSC during the year 2018:

Mr R M P Rathnayake, NE/NI – Chairman
(from 26 November 2018 to 19 February 2019)

Mr Aswin De Silva, NE/NI – Chairman
(from 3 February 2017 to 12 November 2018)

Mr D L P R Abeyaratne, NE/NI – Member
(from 3 February 2017 to 11 July 2018)

Mr Chandima Hemachnadra, NE/NI – Member
(from 3 February 2017 to 19 July 2018)

Mr Anil Rajakaruna, NE/NI – Member
(from 26 October 2018 to 31 December 2018)

Ms Shehara Jayawardena, NE/NI – Member
(from 26 October 2018 to 12 November 2018)

(NE – Non-Executive, NI – Non-Independent,
I – Independent)

The details on current composition of the Committee and the profiles of the present members are given on page 154 and 131 to 133 respectively.

Regular attendees by invitation

The General Manager/CEO provides information to the Committee and attends all meetings of the Committee. as an invitee.

Assistant General Manager (IT) and Chief Information Security Officer also attend the meeting on invitation.

Secretary to the Committee

The Secretary to the Board, functions as the Secretary to the BITSC.

Meetings

During the financial year ended 31 December 2018 three BITSC meetings were held and minimum quorum of the Committee is two-thirds as per the charter of the BITSC.

Attendance of the Committee members during the year are as follows:

Name	Eligible to attend	Attended
Mr Aswin De Silva	03	03
Mr D L P R Abeyaratne	02	02
Mr Chandima Hemachandra	02	02
Mr Anil Rajakaruna	01	01
Ms Shehara Jayawardena	01	–

Charter of the Committee

The Board of Directors of the Bank has established the Board Information Technology Strategy Committee (BITSC) in compliance with the Banking Act Direction No. 12 of 2007, Corporate Governance for Licensed Specialised Banks in Sri Lanka issued by the Monetary Board of the Central Bank of Sri Lanka under section 76 J (1) of the Banking Act No. 30 of 1988 as amended.

The BITSC was established in order to ensure the Banks reliance over Information Technology and oversee the Bank's strategic objectives in accordance with the Information and Communication Technology (ICT).

Role and responsibilities of the Committee

Establish and review Information Technology Governance Framework to ensure leadership support, organisational structure and Bank's IT process, value delivery, IT risk management, resource management and performance management.

Ensure adequacy and effectiveness of Business Continuity Management and Disaster Recovery of Information Communication Technology Systems of the Bank.

Ensure adequacy and effectiveness of Information Systems Security according to CBSL directions and international best practices.

Activities attended by the Committee during the year 2018

The Committee-approved policies and procedures in order to enhance information technology infrastructure, enabling the banking functions more linked with the emerging technologies to ensure efficient and effective implementation over the strategies of the Bank. Moreover, the Committee foresees the need of customer's data protection and ensures all necessary policies and procedures have been taken against the information security.

Focus for 2019 and beyond

- Continuous focus to stay ahead of the cybersecurity-related matters.
- Maintenance of IT Governance Framework as a core function of strength.
- Continuous scanning of innovations and agility in the market to defense against disintermediation and position on growth.

Committee evaluation

The Committee completed the evaluation process with self-assessment for the year 2018 and concluded that its performance was effective, where the results of the evaluation were communicated to the Board.

R M P Rathnayake
Chairman
Board Information Technology Strategy Committee

14 March 2019
Colombo

Board Information Technology Strategy Committee

Strategic objectives	Stakeholders	Material risks
Heightening customer experience	Customers	Strategic risk
Reinforcing risk culture	Employees	Cybersecurity risk
Promoting organic growth	Shareholders	Reputational risk
Leading by example	Regulators and Government Institutions	Compliance risk
		Model risk
		Operational risk
Refer pages 40 to 50 for more details.	Refer pages 54 to 59 for more details.	Refer page 140 for more details.

Risk Management

NSB is exposed to both financial and non-financial risks arising from its operations. Thus, the Bank's overall objective is to manage these risks in a manner that balances serving the interests of its customers and investors on one hand and solvency on the other hand.

The scope of risk management is not limited to NSB, but also extends to the fully owned subsidiary, NSB Fund Management Company. This report mainly elaborates risk management in the Bank considering the materiality of the Bank's operation in the NSB Group. (Bank contributes 98.6% to consolidated assets and 97.7% to consolidated capital)

The Bank manages these risks through its risk management framework which evolves with emerging risks arising from the changing business environment, better approaches and regulatory expectations.

Risk management framework

NSB's risk management framework enables the appropriate development and implementation of strategies, policies and procedures to manage its risks. Ownership and responsibility for risk management lies with all individuals engage in business operations. Sound corporate governance principles coupled with the "Three Lines of Defence Model" are entrenched to risk governance framework of the Bank.

The risk management framework is supported by following key documentary components:

Strategic Business Plan (SBP)	SBP summarises the Bank's approach to implement its strategic objectives. The Plan has a rolling three-year duration and reflects material risks arising from its implementation.
Risk Appetite Statement (RAS)	RAS articulates the types and degree of risks the Board is prepared to accept (Risk Appetite) and the maximum level of risk that the Bank must operate within (Risk Tolerances).
Risk Management Policy Framework	Risk Management Policy Framework documents the risk management approach and describes how the Bank ensures comprehensive management of risks across the Bank in support of achieving its strategic goals. Risk Management Policy Framework consists of the following: → Integrated Risk Management Policy → Credit Risk Management Policy → Market and Liquidity Risk Management Policy → Operational Risk Management Policy → Risk Management Disclosure Policy → Stress Testing Policy → Internal Capital Adequacy Assessment Process (ICAAP) Policy

Risk management framework is implemented in an integrated manner to cover a broad spectrum of emerging and existing material risk areas such as credit, market, liquidity, operational, compliance, reputation and strategic, with controls and governance established for each area as appropriate. A comprehensive risk management framework is applied throughout the Bank with policies, procedures, and infrastructure reinforced by the risk management culture.

Types and approach to manage material risks

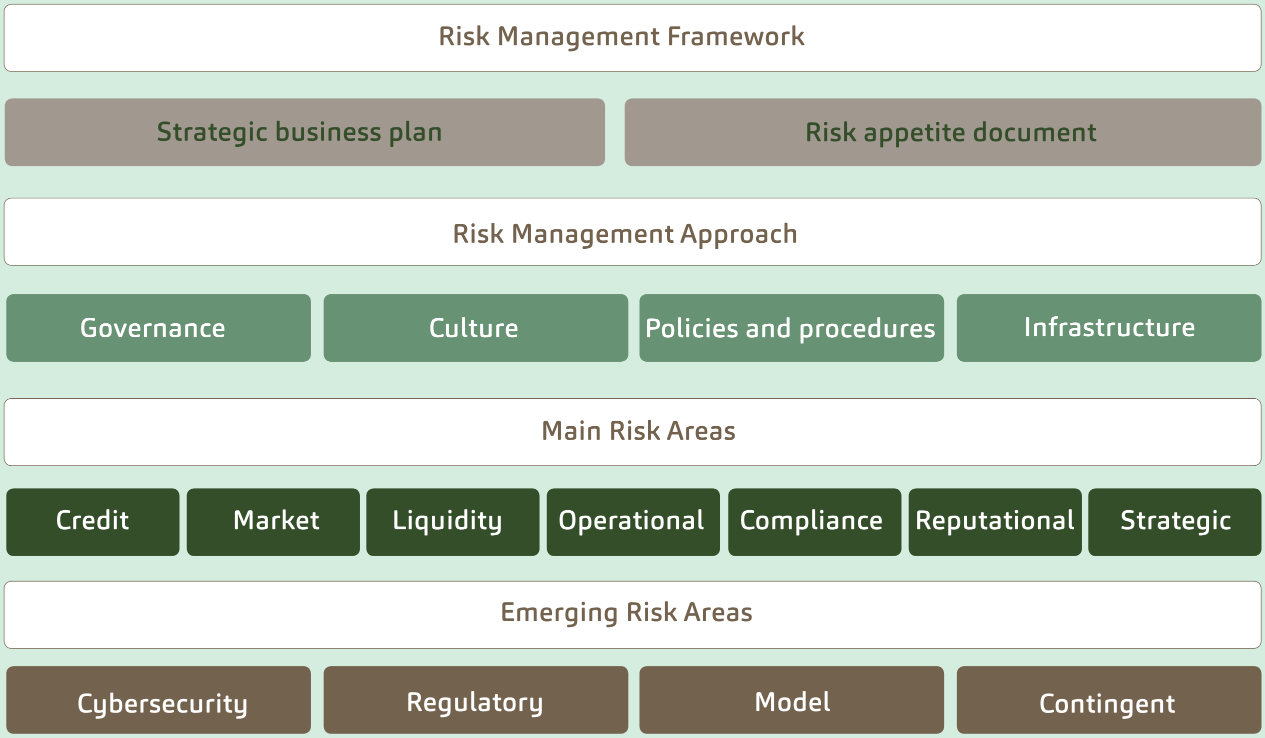


Figure 1

Risk Management

Governance

NSB is committed to ensure that its risk management practices reflects a high standard of governance. This enables the Board and the Senior Management to effectively and prudently undertake risk-taking activities. The Board of Directors operates as the highest level in the governance framework.

The BIRMC oversees the risk management framework and helps to formulate the Bank's risk appetite for the consideration of the Board. Risk governance flows throughout the business functions of the Bank via Risk Appetite Statement, policies, delegated authority, and committee structures.

Risk management governance structure

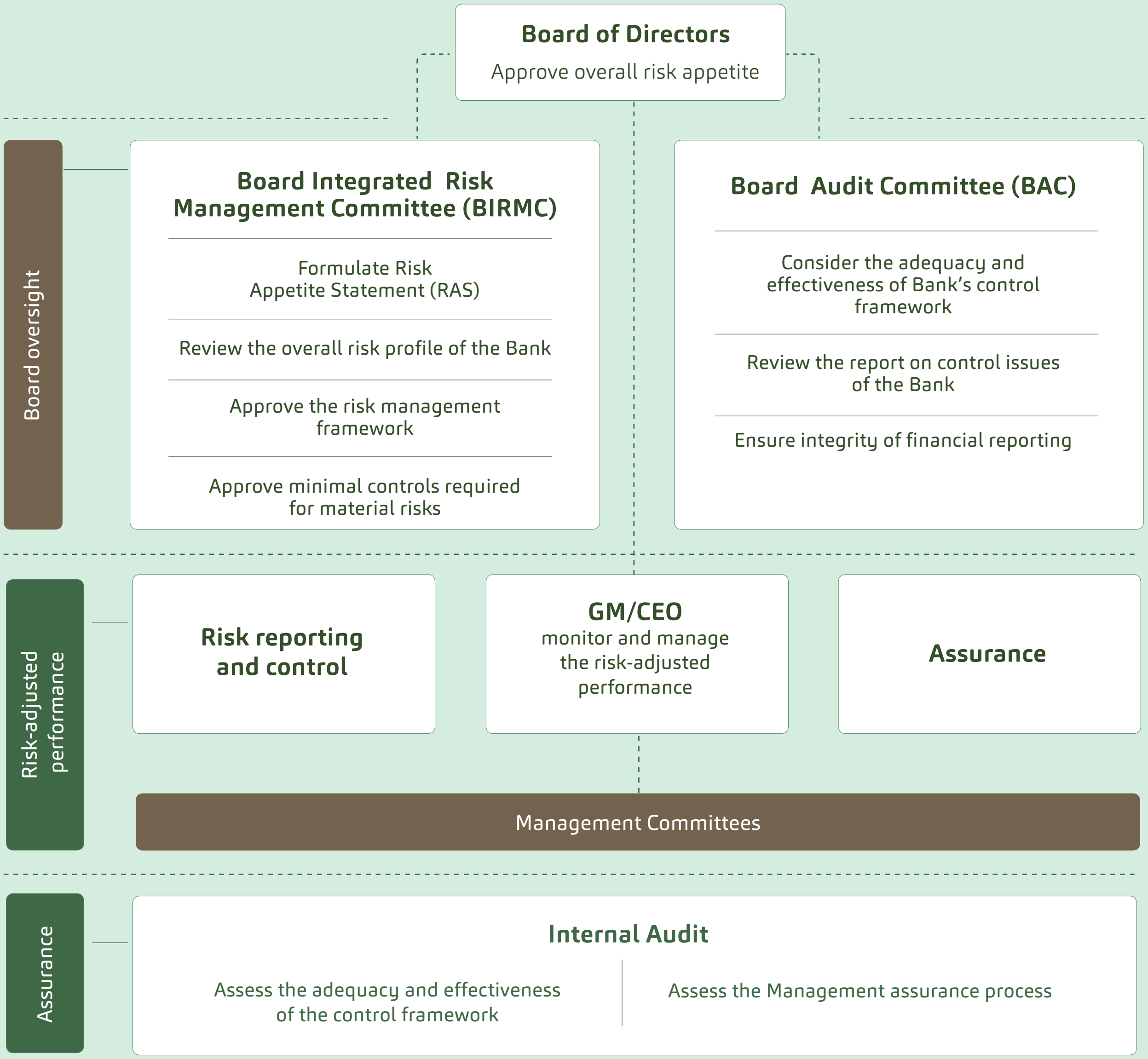


Figure 2

Board	The Board, through the risk oversight role ensures that Senior Management of the Bank has established an integrated framework to manage various risk exposures and to ensure internal policies are appropriately established and complied with. The Board approves the Bank's overall risk appetite and oversees its implementation while reviewing the same to ensure that it continues to be relevant and reflects all types of risks, markets and macroeconomic conditions. Further, the Board ensures that sound internal control and assurance framework exists within the Bank and is responsible for taking necessary steps to foster a culture of risk awareness and risk adjusted decision making.
BIRMC	BIRMC assists the Board in fulfilling its risk-related responsibilities to recommend an effective risk management framework to the Board. Key purposes of BIRMC are to establish risk appetite and recommend the ICAAP. BIRMC monitors the Bank's compliance with risk management framework. It reviews adequacy of all management level committees, significant correspondence with the regulator and the risk profile of the Bank.
BAC	The policies and practices used by the Bank to manage risks are debated by the BAC. It monitors the effectiveness and efficiency of internal control processes and internal audit function. BAC ensures integrity of information, usage of appropriate accounting policies and monitors legal or regulatory compliance issues. It recommends interim and year-end financial statements to the Board for approval before publication. External Auditors report their findings to the BAC.
Management Committees	Management level committees, directly involved in managing the principal risks, include Credit Committee (CC), Asset and Liability Management Committee (ALCO), Investment Committee (IC), and Operational Risk Management Committee (ORMC). Other management committees such as IT Steering Committee (ITSC), Corporate Management Committee (CMC), Performance Review Committee (PRC), Marketing Committee (MKTC), Product Development Committee (PDC) , Human Resource Committee (HRC), Action Plan Review Committee (APRC), IT Review and IT Security Committee (ITR and ITSec), Branch Operations Steering Committee (BOSC), Corporate Procurement Committee (CPC) manage material risks to the Bank from people, processes, systems, and external risk drivers.

The Bank is using Three Lines of Accountability model, which places accountability for risk ownership. This model recognises that the business is best positioned to make optimal long-term risk-reward decisions that consider the full end-to-end value chain. Risk and compliance provides the guidance, advice and assurance for the business owners to manage the risks, while audit provides independent assurance to the Board.

Regulators and External Auditors provide valuable inputs to strengthen internal controls and risk management framework, which is an additional assurance to the stakeholders of the Bank.

Risk Management

Three Lines of Defence in risk management

First Line of Defence	Second Line of Defence	Third Line of Defence
Business Units **Branches/operational divisions** are accountable for identifying/ addressing the risks in their respective business areas to operate within a sound control environment. All staff members attached to branches/operational divisions are aware/responsible for the risks taken and to abide by the internal controls/risk management practices.	**Risk Management and Compliance** **Risk Management Division (RMD)** is the risk oversight division engages in formulating risk management policy framework, risk aggregation, escalation and risk reporting. **Compliance Division** focuses on overseeing compliance with laws, rules and regulations applicable to the business operations of the Bank. *(RMD and Compliance Divisions independently report to BIRMC/ Board).*	**Internal Audit** **Internal Audit Division (IAD)** ensures the adequacy of internal controls, risk management function and compliance function by conducting independent regular audits on the implementation of risk management practices, compliance function and internal controls. *(IAD reports the audit findings to the Board through BAC)*

Figure 3

Risk culture

Culture is the collection of values, skills and habits that equip employees to understand the risks and make sound judgements in the absence of definitive rules, regulations or market signals. The employees at all levels understand the risk in respective business operation. The Bank's risk culture is a key driver to ensure risk and return trade-off and managing of the risks and capital levels.

Risk policies and procedures

Integrated Risk Management Policy Framework and the operational level policies and procedures provide guidance to the business on management of each material risk.

Integrated Risk Management Policy Framework summarises the principles and practices to be used in identifying and assessing its material risks, quantifying the risk appetite and tolerances for material risks and to clearly understand the types of risk outcomes to which the Bank is intolerant.

Infrastructure

Risk management framework is supported by necessary systems, processes and skills required for the management of material risk types.

The key risk management processes in place include:

- Process to assess the risks based on management information.
- Credit risk management solutions with bank specific credit rating and scoring models.
- Models to assess the risk adjusted returns at transaction level and portfolio level.
- Market Risk Assessment Models
- Key Operational Risk Indicators (KORIs)
- Loss event data collection process
- Risk and Control Self-Assessment (RCSA) process
- ICAAP is used in combination with other risk management practices (including stress testing) to understand, manage and quantify the risks, the outcomes of which are used to inform risk decisions, strategic planning and capital planning.

NSB has introduced improvements essential to strengthen the risk management framework to evaluate, monitor, and manage material risks assumed in the course of its operations. Risk management policies, procedures, and systems are established in line with the guidelines issued by the CBSL and the international best practices introduced by the Basel Committee.

Risk appetite →

The Risk Appetite Statement is a key component of the risk management framework. Risk appetite is the level of risk the Bank is willing to take to achieve its objectives. It reflects the key aspects of business and stakeholder expectations.

Risk appetite is an integral element of NSB's business planning process. Risk Appetite Statement enhances value by aligning business operations and risks. It facilitates the staff at business divisions to understand the level of risk they are prepared to take in pursuit of daily business operations, so that they can take decisions risk consciously.

Top down approach in setting risk appetite at corporate level using qualitative and quantitative parameters that minimise adverse impacts to the Bank's values and financial position. Quantitative risk appetite at corporate level focuses mainly on capital adequacy, liquidity, profitability and other prudential requirements.

Implementing risk appetite framework

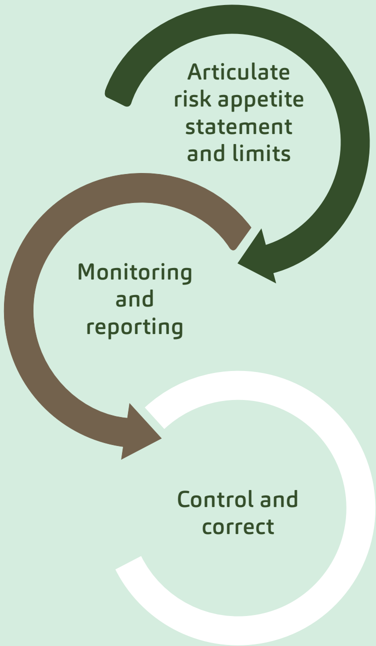


Figure 4

The qualitative statements mainly include risks for which the Bank has zero risk appetite. At business line level, risk appetite limits are by risk types namely credit, equity, interest rate, forex and operational.

Convergence of top down and bottom up approach is used at divisional and product line level to set more prudent risk appetite levels using Limit Structures, Budgeted Levels and KORIs.

NSB's Risk Appetite Statement is approved by the Board of Directors on an annual basis or more frequently in the event of unexpected changes to the risk environment, with the aim of ensuring that they are consistent with Bank's business strategy and regulatory environment and stakeholders' requirements. The Board has the ultimate responsibility to manage the risk within the risk appetite levels and has delegated the responsibility to BIRMC.

Communicating risk appetite

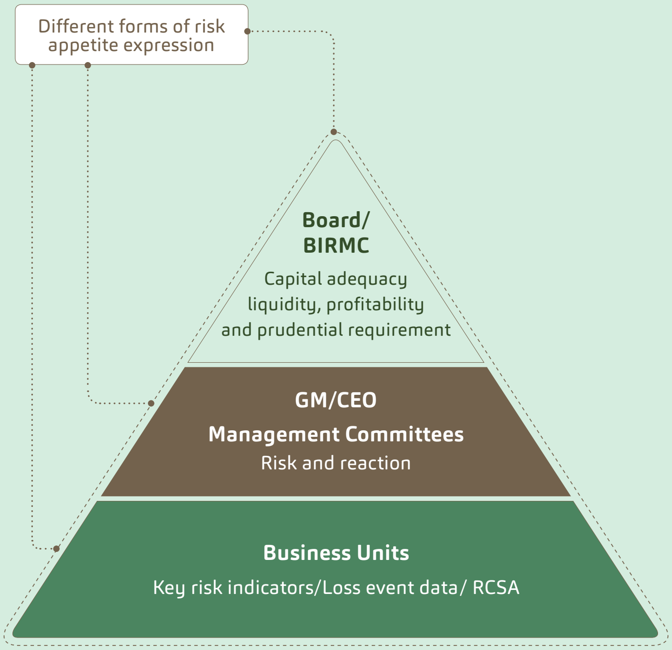


Figure 5

RMD monitors actual performance against qualitative and quantitative risk appetite parameters and communicated to different levels in governance structure.

Risk Management

The Bank is within the risk appetite and tolerance limits set for the liquidity. The total capital adequacy ratio (CAR) of the Bank is within the maximum tolerance limit however, was not able to achieve the risk appetite levels mainly due to reduction in profitability during the year 2018 as indicated by the profitability indicators.

The reduction in profit is due to multiple factors including fluctuations in market variables, impact from Inland Revenue Act No. 24 of 2017, Debt Repayment Levy (DRL) and adoption of SLFRS 9.

Strategic level key risk indicators

Indicator	Risk level: Within risk appetite limit	Risk level: Within the maximum tolerance limit	Risk level: Below maximum tolerance limit
Profitability			
ROA			✓
ROE			✓
Capital adequacy			
Capital adequacy ratio – Tier 1	✓		
Capital adequacy ratio – Total		✓	
Leverage	✓		
Liquidity			
Liquidity – SLAR	✓		
LCR (all currency)	✓		
NSFR	✓		

Figure 6

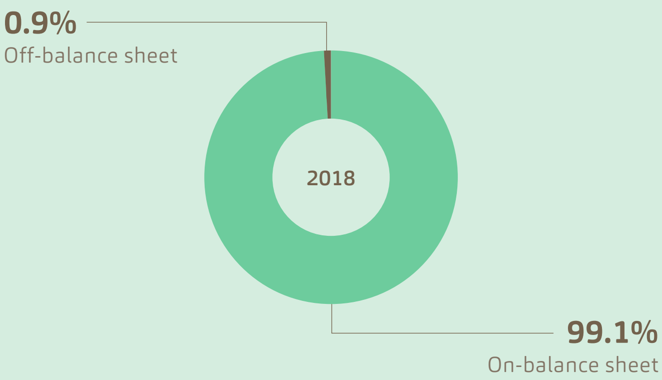
Understanding the challenges to achieve strategic objectives due to material existing and emerging risks, the Bank promotes to develop an integrated risk management framework to manage different types of risks to minimise the adverse impact on the key performing areas such as profitability, liquidity and capital adequacy, and to the overall functions of the Bank.

Credit risk

Credit risk is the risk of potential financial loss arising from the inability or failure of a borrower or counterparty to meet its financial or contractual obligations to the Bank.

The Bank is exposed to credit risk both from on and off-balance sheet credit exposures. The maximum exposure to credit risk is 95.5% of the Bank's total assets. Credit risk to the Bank comprises counterparty risk, concentration risk, settlement risk, and residual credit risk.

On and off-balance sheet exposure



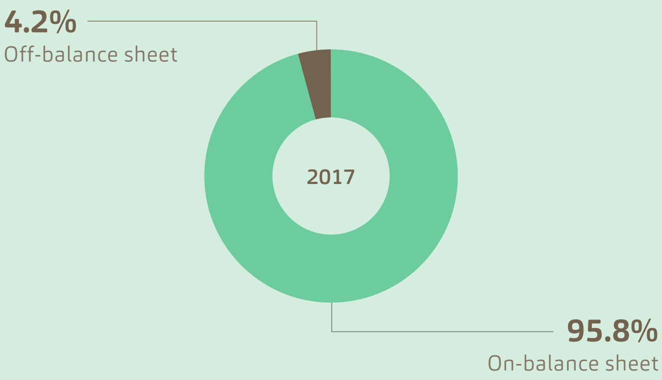


Figure 7

Loans and receivables to banks and other customers, and investment in debt securities are the main sources of credit risk to the Bank.

On-balance sheet exposures

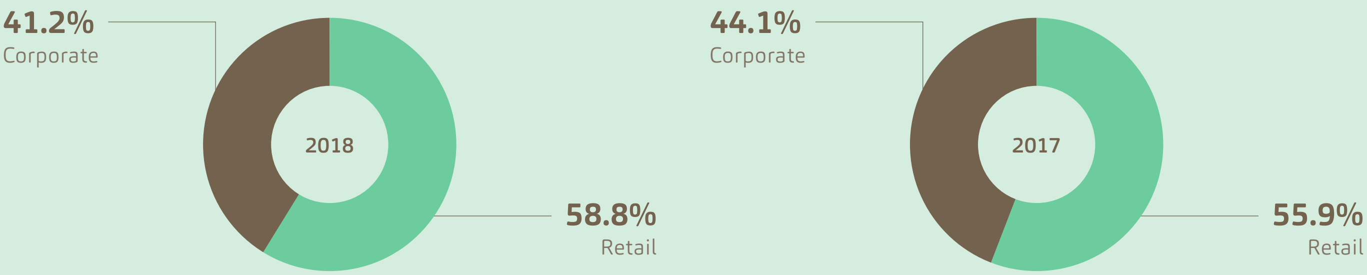


Figure 8

Retail credit exposures

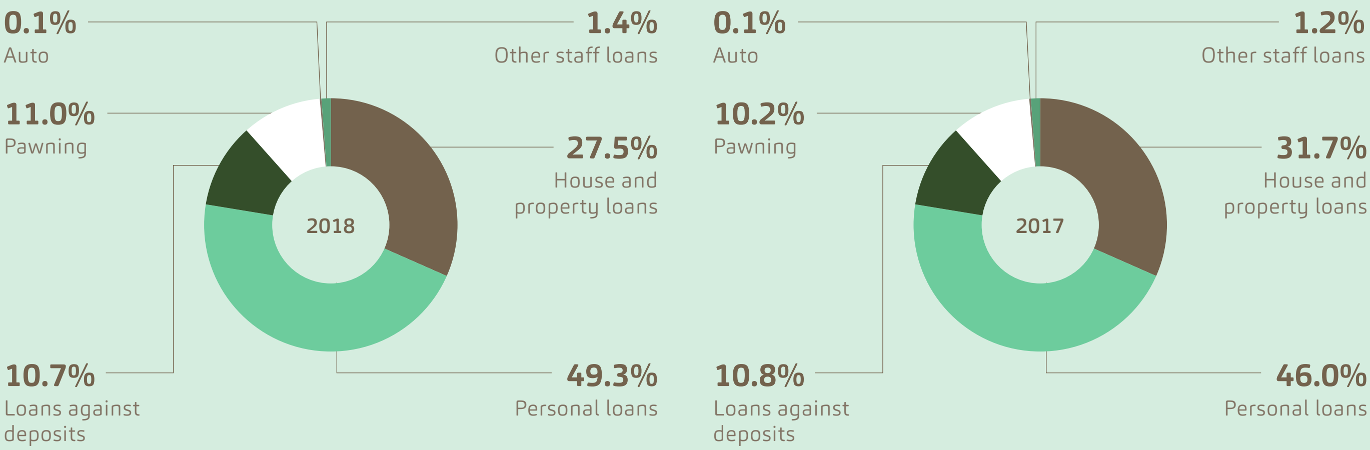


Figure 9

Corporate lending and investment exposures

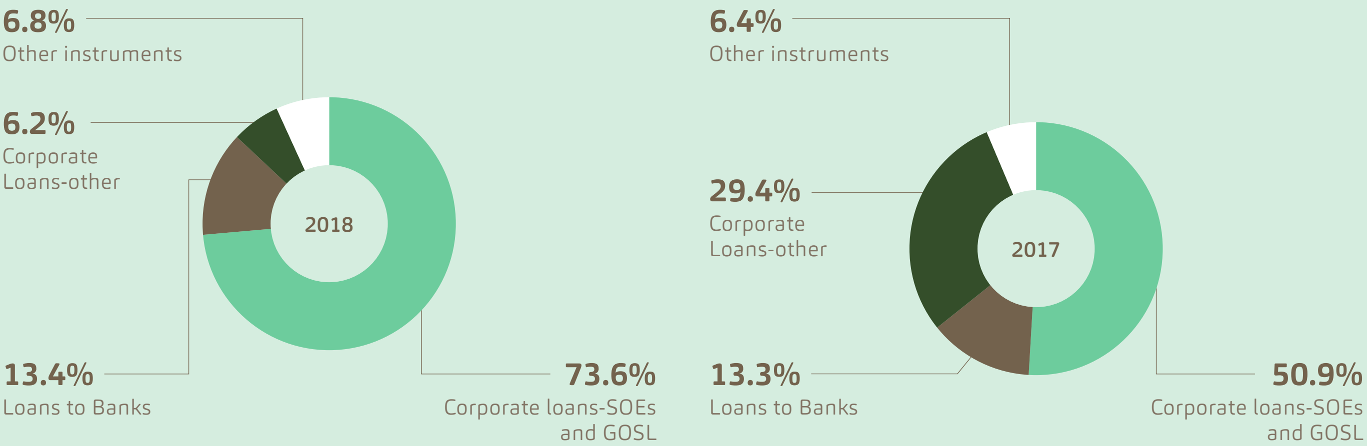


Figure 10

Risk Management

Risk review

Credit risk review

Risk component	Description	Monitoring/Management tools	Exposure	Impact*
Counterparty default risk	Possible impact due to failure of counterparties to meet contractual obligations with the Bank according to the agreed terms	→ Monitoring of early warning indicators → NPA trends → Loan Review Mechanism(LRM)	High	Low
Concentration risk	Uneven distribution of counterparties in credit to an industry sector or geographical region	→ Herfindahl-Hirschman Index (HHI) → Limit monitoring → Stress testing	Moderate	Moderate
Settlement risk	Possible impact due to failure of delivering on the terms of a contract at the time of settlement	→ Credit rating/scoring → Stress testing → Limit monitoring	Moderate	Low
Residual risk	Possible impact from any remaining risks after all other risks are eliminated, hedged or otherwise accounted	→ Collateralisation → Monitoring of valuation/ revaluation → Monitoring of Loan to Value (LTV) ratios	Moderate	Low

* Possible impact on earnings and capital in a high stress situation

Table 1

Counterparty default risk

Counterparty default risk is the most significant element of credit risk arises from the risk that parties are unable to meet their payment obligations under agreed terms and conditions.

Credit risk management process encompasses credit risk management techniques and tools formulated according to the regulations and guidelines provided by the regulator and Basel requirements to mitigate the counterparty default risk. Customer due diligence, delegated authority and exposure limits, post disbursement loan monitoring, Internal Credit Scoring/Rating systems and LRM are established to manage and monitor the counterparty default risk.

The Bank's gross NPL ratio is 1.44% in 2018 which is below the industry NPL ratio of 3.4%, however, above the 2017 ratio of the Bank.

NPL vs loan amount

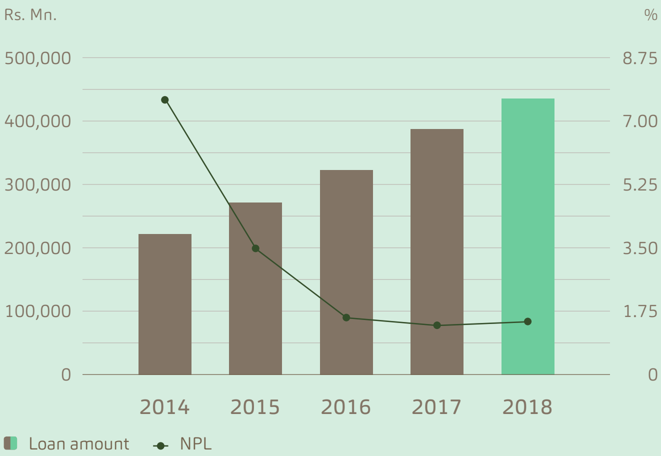


Figure 11

Age analysis of NPL

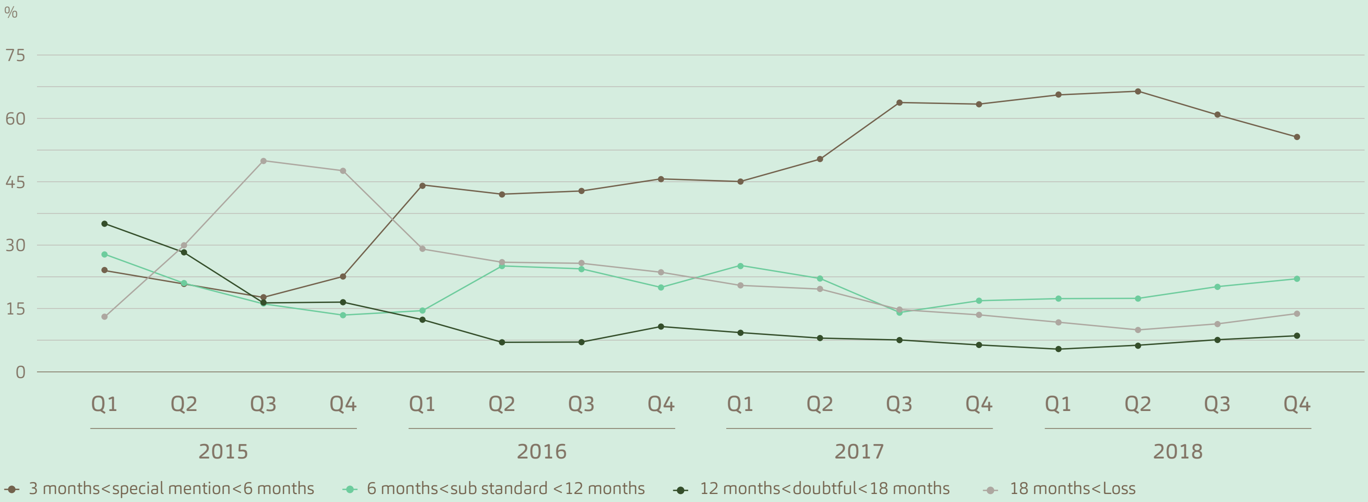


Figure 12

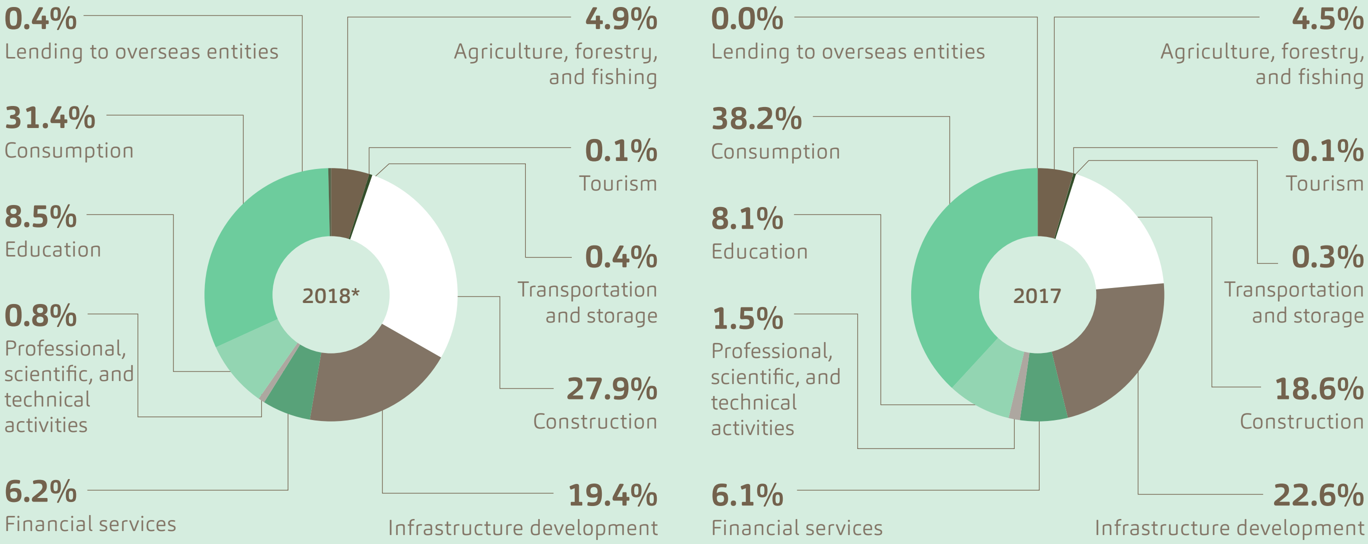
Concentration risk

Concentration risk is the risk of an adverse development in a specific single counterparty, country, industry, or product leading to a disproportionate deterioration in the risk profile of the Bank's credit exposures to that counterparty, country, industry or product.

To assess the concentration in the credit portfolio, NSB uses the Herfindahl-Hirschman Index (HHI). The Bank has a moderate risk appetite towards sector concentration considering contribution to achieve the development goals of the Government. High geographical concentration to the Western Region is due to all corporate loans being booked at the Head Office, Credit Division.

Measures such as monitoring portfolio concentration limits and stress testing are used to manage credit concentration risk.

Sector concentration



*Increased exposure to 'construction' sector is due to reclassification of loan products previously categorised under 'consumption' sector

Figure 13

Risk Management

Geographical concentration

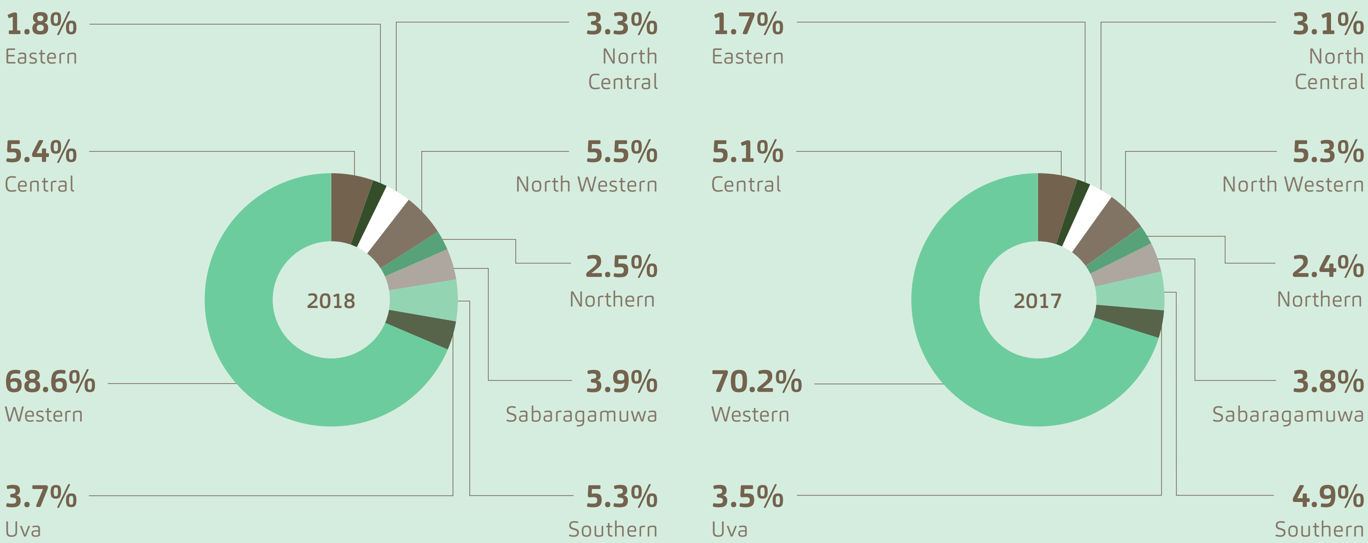


Figure 14

Settlement risk

Settlement risk is arising from failure of the counterparty to deliver counter value, usually the underlying asset or cash value of the contract, as per the terms of the contract at the time of settlement. Settlement risk is closely associated with default risk along with any timing difference in settlement.

NSB has established comprehensive limit framework to monitor counterparty settlement risk from credit and other trading transactions.

Residual risk

Residual risk is identified as remaining amount of risk after control mechanisms mitigate the inherent risks of the Bank. Risk governance framework is incorporated with strong controls and risk mitigation techniques. Residual credit risk is maintained within risk appetite levels using acceptable collateralisation with in predefined LTV ratios and strict recovery procedures.

With the increase in composition in personal loans based on personal guarantee, there is an increase in residual risk in credit, however 26% of the credit portfolio is backed by government guarantee and 17% of credit portfolio is covered by property mortgages.

Credit risk management structure

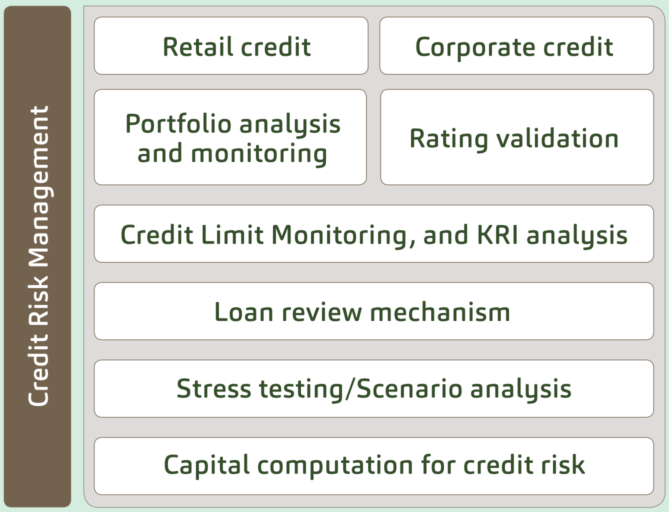


Figure 15

Credit risk management structure is founded on the risk appetite and limit structure, credit risk management policies, delegated authorities, and committee structure.

Credit risk governance emanates at the Board level with the assistance of BIRMC and BCC. At the Senior Management level CC and IC have the oversight responsibility for credit risk management.

Credit Risk Management Unit (CRMU) of the RMD is responsible for providing with a clear and comprehensive understanding of the credit risks to the Board, BIRMC and the Senior Management. The responsibilities of CRMU include:

- Renew/update policies
- Develop and maintain quantitative risk models
- Risk appetite limit monitoring
- Credit risk review at transaction and portfolio levels
- Conduct loan reviews
- Monitor Key Risk Indicators (KRIs) and early warning indicators
- Report to CC, IC and Board through BIRMC

Credit risk management process

Effective management of credit risk is a critical component of a comprehensive risk management approach and essential for the long-term success of any bank.

The goal of credit risk management at NSB is to optimise the risk adjusted rate of return by maintaining credit quality and credit risk exposure within risk appetite levels.

The Bank exerts a set of risk management tools and techniques to manage the credit risk inherent at portfolio level as well as at transaction level.

Risk rating and scoring

Risk rating and scoring models are used to assess the credit worthiness of the counterparties. Rating and scoring methodology developed based on Basel guidelines and aims to deliver a consistent approach to risk assessment framework by considering both qualitative and quantitative risk parameters.

Credit rating of the Bank comprehensively assesses the obliger and facility risk ratings and assign with a rating grade from a scale of nine internal rating grades and external rating of the respective borrowers are considered and compared with internal ratings generated until independent validation of the system is carried out.

All customers are given a single scale score which reflects the creditworthiness of the counterparty to a specific product. Customers are offered with rate differentials based on Risk Based Pricing (RBP).

Collateral management and valuation

The Bank considers collateral as a reliable guarantee to mitigate financial risk and security on credit facilities. Type of the collateral comes in various forms and the Bank accepts collateral based on the facility type.

The collateral value should be sufficient to fully cover the principal, interest, legal and other charges. Bank ensures to maintain LTV ratio of immovable property, pawning and cash backed lending within acceptable levels to cover all dues.

The property mortgages accepted as collateral are revalued based on Policy on Valuation and Revaluation of Immovable Property developed in compliance with the CBSL Directions.

CRMU monitors the revaluation due loans as early warning indicator to take immediate action to mitigate risk. In the year 2018, 77.72% of the property mortgage loans were backed by immovable property with LTV ratio of less than 50%.

Loan portfolio-collateral wise

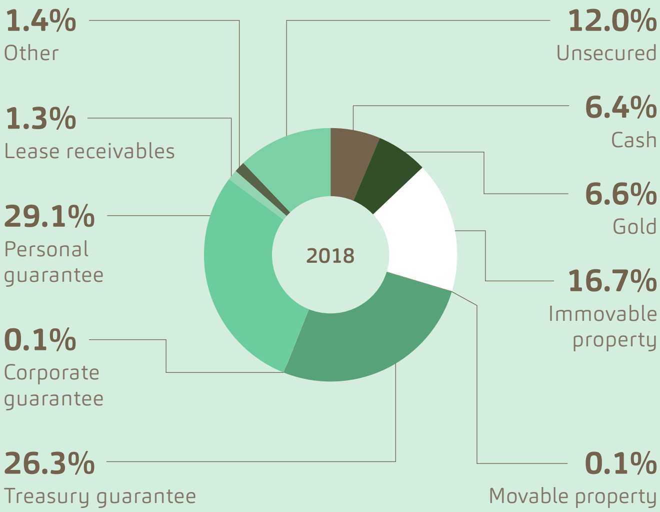


Figure 16

Risk Management

LTV distribution of loans backed by immovable property

As at 31 December	2018		2017	
	Rs. '000	**Composition (%)**	Rs. '000	Composition (%)
LTV ratio				
Less than 50%	**53,692,612**	**77.72**	51,515,268	78.45
50-75%	**13,748,040**	**19.90**	12,160,610	18.52
More than 75%	**1,647,432**	**2.38**	1,988,195	3.03
	69,088,084	**100.00**	65,664,073	100.00

Table 2

Loan review mechanism

The Bank uses LRM as an effective tool to mitigate the credit risk by prompt identification and rectification of gaps in credit granting and documentation process. This process ensures quality assurance in the credit process and the credit quality.

The Bank's LRM process covers credit operation at head office and branch level. CRMU reviews a sample from corporate loans and retail loans above a threshold of Rs. 10 Mn. within three months of sanction and reports to the CC.

Impairment provision

With the introduction of Expected Credit Loss (ECL) approach in SLFRS 9, credit losses increased with more volatility for financial instruments. Lifetime expected credit loss or twelve months expected credit loss is calculated either on individual basis or collective basis for financial instruments based on a predetermined threshold limit. The Bank has implemented standardised ECL model for impairment assessment.

The actual impact of adopting SLFRS 9 on 1 January 2018 has increased loan loss provision. Provision cover of the Bank is 63% for the year 2018.

Impairment provision vs NPL

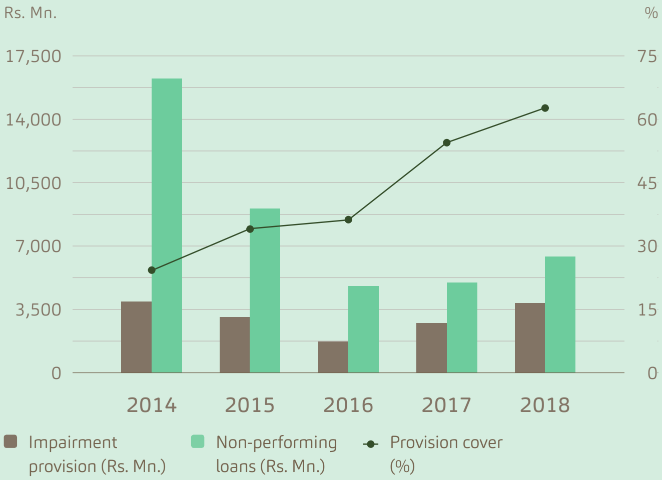


Figure 17

Market risk

Market risk is the risk that the value of both on-balance sheet and off-balance sheet financial assets and liabilities will fluctuate resultant to the changing market prices, regardless of whether these price changes are originated by factors typical for individual instruments or their issuer or counterparty or by factors pertaining to all the instruments traded on the market. Hence, the market risk is connected with the unpredictable price changes in four main financial markets i.e. debt security market, stock market, foreign currency market and commodity market.

The Bank is exposed to interest rate risk, equity price risk, foreign exchange risk in both trading book and banking book resultant to the fluctuations in market variables. The Bank has no direct exposure for commodity price risk as there are no investments in commodities. However, changes in world commodity prices such as gold prices and crude oil prices indirectly affect business activities.

Unfavourable movements in interest rates, equity prices, and exchange rates cause decline of market value of financial instruments, actual and effective earnings i.e. future cash flows from financial instruments.

Market risk exposure

As at 31 December 2018	Carrying amount Rs. '000	Market risk measurement: Trading portfolio Rs. '000	Market risk measurement: Non-trading portfolio Rs. '000	Primary market risk factor: IRR	Primary market risk factor: Fx	Primary market risk factor: Equity
Assets subject to market risk						
Cash and cash equivalents	3,434,524	–	3,434,524	✓		
Placements with banks	17,588,445	–	17,588,445	✓	✓	
Derivative financial instruments	4,740,106	4,740,106	–	✓	✓	
Financial assets measured at fair value	16,680,382	16,680,382	–	✓		✓
Financial assets at amortised cost – Loans and receivables	423,532,145	–	423,532,145	✓	✓	
Financial assets at amortised cost – Debt and other instruments	518,947,969	–	518,947,969	✓		
Financial assets measured at fair value through OCI	6,184,430	6,184,430	–	✓		✓
	991,108,001	27,604,918	963,503,083			
Liabilities subject to market risk						
Due to banks	77,119,146	–	77,119,146	✓		
Derivative financial instruments	1,533	1,533	–	✓	✓	
Financial liabilities at amortised cost – Due to depositors	839,574,411	–	839,574,411	✓		
Financial liabilities at amortised cost – Due to other borrowers	14,804,802	–	14,804,802	✓	✓	
Debt securities issued	52,389,133	–	52,389,133	✓	✓	
Retirement benefit obligations	3,830,795	–	3,830,795	✓		
	987,719,820	1,533	987,718,287			

Table 3

The Bank has a mandatory requirement to invest 60% of customer deposits in Government Securities. In the year 2018, the Bank held 60.9% of the deposits and 50.6% of total assets in Government Securities (trading and banking book) exposing the Bank to interest rate risk accompanied by changes in yields/interest rates.

Equity investments is relatively insignificant (1.1%) of the Bank's total investments where 33% is in trading portfolio and 67% in strategic investments. The Bank's total equity investments is only 0.6% of total assets as at end 2018.

The Bank's foreign currency operations include foreign currency trading, accepting deposits, remittances, borrowing, lending, placements and dealing in derivatives.

Risk review

Market risk is reviewed in terms of interest rate risk, foreign exchange risk (FX) and equity price risk. This is done for traded and non-traded portfolios. The Bank reviews the market risk profile using different methodologies and models.

Market risk review

Risk component	Description	Monitoring/management tools	Exposure	Impact*
Interest rate risk				
Repricing risk	The risk arises from timing differences between rate changes or cash flows from rate sensitive on and off-balance sheet assets and liabilities	→ Monitoring repricing gap limits and limits on Rate Sensitive Assets (RSA) and Rate Sensitive Liabilities (RSL)	High	High
Yield curve risk	Risk of short-term rates changing by more or less than the change in long-term rates	→ Sensitivity/Stress testing with rate shocks	High	High
Basis risk	Risk from unequal movements in interest rates on RSAs and RSLs with the same maturity or repricing dates	→ Sensitivity of rate shocks on RSAs and RSLs	High	High
Foreign exchange risk	Possible impact on earnings and capital arising from adverse changes in exchange rates arising out of maturity mismatches in Foreign Currency positions	→ Limit monitoring → FX VaR → Stress testing	High	Moderate
Equity risk	Possible losses arising from changes in equity market prices	→ Equity VaR → Limit monitoring → Marking to market trading and AFS portfolio on daily basis.	Low	Low
Commodity risk	Possible negative impact on earnings due to changes in prices of commodities (Gold)	→ Indirect impact on value of collateral against pawning advances	No direct exposure	

* Possible impact on earnings and capital in a high stress situation

Table 4

Interest rate risk →

Interest rate risk is the risk of reduction in earnings and capital which deteriorate the net worth of the Bank due to probable changes in interest rates. The immediate impact of changes in interest rates is on the Net Interest Income (NII). Long-term impact of changing interest rates is on the net worth since the economic value of a Bank's assets, liabilities and off-balance sheet positions get affected due to changes in market interest rates.

The Bank is exposed to interest rate risk arising from its investments in trading book as well as the mismatches in repricing periods of RSA and RSL in the banking book.

The management of interest rate risk is one of the critical components of market risk management. The NII or Net Interest Margin (NIM) is dependent on the movements of interest rates. Mismatches in the cash flows (fixed assets or liabilities) or repricing dates (floating assets or liabilities), expose the Bank's NII or NIM to variations. The earnings on assets and the cost on liabilities are closely related to market interest rate volatility.

Management of interest rate risk aims at capturing the risks arising from the maturity and repricing mismatches and is measured both from the earnings and economic value perspectives.

The Bank assesses interest rate risk primarily through an interest rate repricing gap analysis. Interest rate repricing gap analysis measures the difference between the amount of interest-earning assets and interest-bearing liabilities which are repriced within defined maturity buckets.

Interest rate sensitivity analysis

	<1 month Rs. Mn.	1-3 months Rs. Mn.	3-6 months Rs. Mn.	6-12 months Rs. Mn.	1-3 years Rs. Mn.	3-5 years Rs. Mn.	>5 years Rs. Mn.
RSA	37,127	34,022	33,377	112,026	219,274	207,322	334,168
RSL	225,453	268,398	165,580	288,286	25,333	10,836	–
Period GAP (RSA-RSL)	(188,326)	(234,376)	(132,203)	(176,260)	193,941	196,486	334,168
Cumulative gap	(188,326)	(422,702)	(554,905)	(731,165)	(537,224)	(340,738)	(6,570)
Actual gap as a percentage of RSL – 2018	-84%	-87%	-80%	-61%	766%	1,813%	–
Actual gap as a percentage of RSL – 2017	-88%	-88%	-52%	-37%	281%	1,431%	13,966%

Table 5

Interest rate risk in trading book

The Bank held 2.6% of its investments in Government Securities in Fair Value Through Profit and Loss (FVTPL) portfolio (Treasury Bonds) and less than 0.5% in Fair Value through Other Comprehensive Income (FVOCI) portfolio (Treasury Bonds) at the end of 2018. Interest rate risk in Government Securities FVTPL portfolio is assessed through mark-to-market valuation and the yield of the portfolio. Further, portfolio duration is monitored on a monthly basis.

Interest rate risk in banking book

Interest Rate Risk in the Banking Book (IRRBB) is the risk on earnings or capital arising from movements of interest rates that affect banking book positions.

This risk results from different repricing characteristics of banking book assets and liabilities. Maintaining interest rate risk within prudent level is essential to the solvency.

Equity risk

Equity risk refers to the risk that NSB's investments in equity instruments will depreciate due to stock market dynamics exposing to potential variation in income and reserves. The Bank is exposed to equity price risk from its investments in listed equity instruments both ordinary shares and in unit trusts.

The listed equity portfolio comprises both FVTPL and FVOCI portfolios and the extent of investments in equities are managed by risk limits framework and Investment Policy Statement (IPS).

Equity portfolio position

	2018		2017		Unrealised gain/ (loss)
Portfolio type	**Book value Rs. '000**	**Market value Rs. '000**	Book value Rs. '000	Market value Rs. '000	Rs. '000
FVTPL	**3,367,973**	**1,878,919**	3,521,949	2,357,336	(1,489,054)
FVOCI*	**3,107,875**	**3,750,515**	3,107,875	4,440,951	642,640
Total	**6,475,848**	**5,629,434**	6,629,824	6,798,287	(846,414)

* Including unquoted investments

Table 6

Sluggish economic conditions, heightened domestic political uncertainty and volatile global financial markets have affected Sri Lankan equity market negatively in 2018. Colombo equities have fallen 4.98% (317 Index points) in 2018 relative to 2.3% gain reported in 2017. The S&P SL 20 index, which features the CSE's 20 largest and most liquid stocks, has also moved down consistently, making a 14.61% loss (537 Index points) for 2018.

Equity portfolio composition

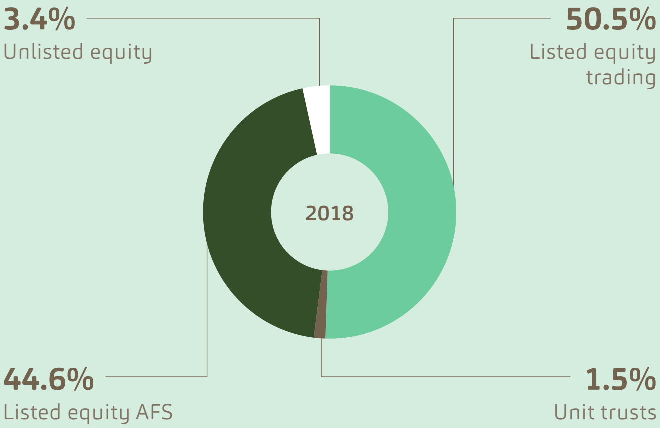


Figure 18

Foreign currency risk

FX risk is the risk that an asset or investment and transactions denominated in a foreign currency will lose value as a result of unanticipated and unfavourable fluctuations in exchange rates. During 2018 USD/LKR average spot rate fluctuated in the range of Rs. 153.33-182.71 (Source: Bloomberg). The rupee depreciation was 19.2% for the year.

US dollar denominated bonds totalling to USD 1,000 Mn. issued in 2013 and 2014 form a part of the foreign currency exposures. During the year under review, the Bank successfully redeemed the obligation on USD 750 Mn. bond issued in 2013. However, the Bank borrowed USD 100 Mn. from a reputed international bank to settle the financial obligation from the bond issue. The facility is floating rated and linked to 6M LIBOR plus 2% margin.

The remaining USD 250 Mn. bond is to be matured in the year 2019; and the foreign currency risk in capital redemption is covered via a SWAP agreement with CBSL. Further, foreign currency exposure has increased during the year due to disbursement of corporate loans in foreign currency.

Foreign currency maturity gaps

Maturity Gap	<1 Months Rs. '000	1-3 months Rs. '000	3-6 months Rs. '000	6-12 months Rs. '000	1-3 years Rs. '000	3-5 years Rs. '000	Over 5 years Rs. '000
USD	(4,360,211)	9,076,532	(8,984,000)	14,712,404	(11,513,547)	2,571,900	3,233,340
EUR	(1,065,702)	(127,100)	(173,989)	5,649,578	–	–	–
GBP	(472,669)	(14,969)	(168,332)	1,078,399	–	–	–
SGD	1,336	–	–	–	–	–	–
AUD	(747,345)	(46,643)	355,165	992,454	–	–	–
JPY	3,018,750	–	–	–	–	–	–
CHF	607	–	–	–	–	–	–

Table 7

FX risk is associated with the unhedged positions in all the foreign currencies. Bank under the Standardised Measurement Approach allocates capital for foreign currency risk considering the Net Foreign Currency Exposure (NFCE). Daily NOP, which is one of the main indicators of foreign currency risk in Treasury operations is monitored on daily basis and limited exceptions are reported (duly approved by relevant authorities) due to accumulation of USD to repay the capital and coupon of USD 750 Mn. bond.

Daily NOP against internal limit – 2018

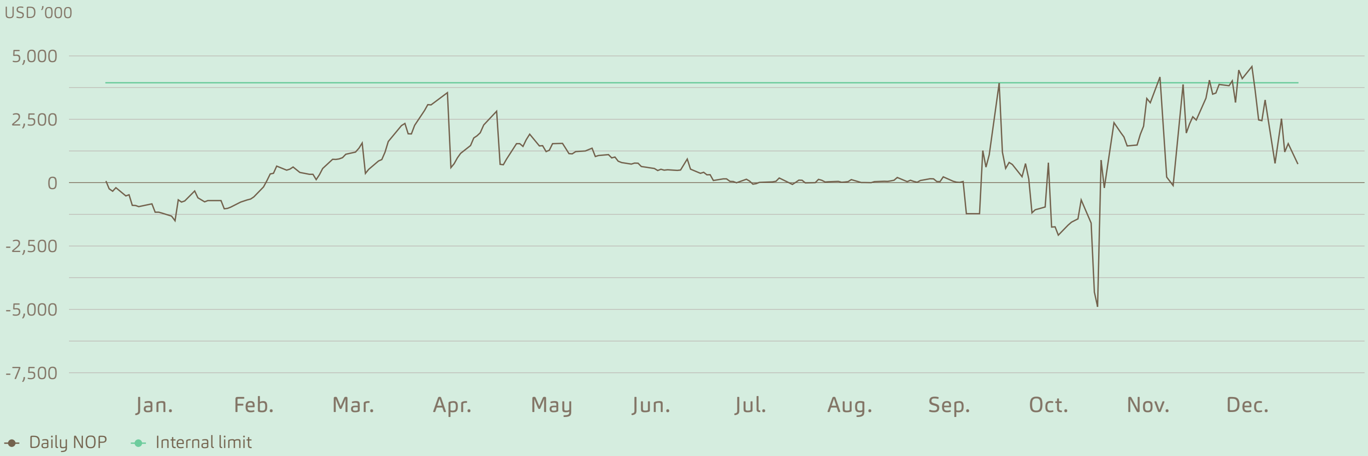


Figure 19

Governance structure

The Bank is equipped with prudent and independent market risk governance framework which is an integral part of the risk management. Market risk governance is a principal responsibility of the Board and management committees.

The Bank's market risk appetite, principles, policies, procedures, controls, and reporting are fully in line with regulations and industry best-practices, to manage the impact of market risk factors on the profitability, capital levels and the risk profile.

ALCO is the apex committee at management level responsible for managing the balance sheet within the performance/risk parameters based on the risk appetite of the Bank. The IC appraises the Board of Directors by recommending actions if considered necessary or desirable to invest or divest investment portfolio or part of it in order to manage the risk in investments.

Market Risk Management Unit (MRMU) of the RMD is responsible for providing with a clear and comprehensive understanding of the market risks to the Board, BIRMC, and the Senior Management. The responsibilities of MRMU include:

- Update policies
- Developing and maintaining quantitative risk models
- Monitoring treasury operations, exposures, and position limits against risk appetite and treasury limits
- Conducting daily reviews and analysis of trading portfolios
- Monitor material risk exposures at transaction and portfolio level

Treasury Middle Office (TMO) which is an integral part of MRMU, functions independently from the Treasury Front Office (TFO) and the Treasury Back Office (TBO) to monitor, measure, analyse and report inherent risk and trading risk emanating from treasury operations of the Bank against predefined risk limits on a daily basis.

The observations and exceptions are directly reported to IC, ALCO and to the Board providing an independent opinion.

Market risk management structure

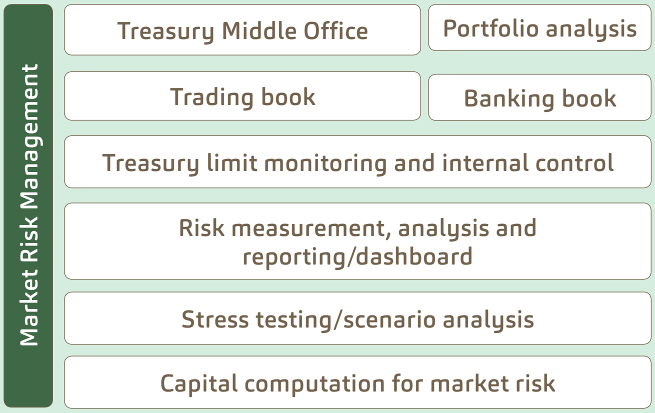


Figure 20

Market risk management process

The Bank manages and controls market risk exposures while maintaining a balanced market risk profile consistent with the risk appetite. For the purpose a range of models, methodologies and tools are used at portfolio and transaction level.

Risk Management

Limits monitoring

A well-designed risk limit framework is one of the key mechanisms for risk control and mitigation. The Bank has set risk appetite and risk limit framework to monitor treasury operations as a function of TMO.

These limits are reviewed on an yearly basis or occurrence of an internal or external event which changes the risk environment. Approval of the Board/BIRMC is obtained for the risk limits.

Risk limits comprise clear authority limits covering entire treasury operations for trading and non-trading portfolios. The risk limits structure is sufficiently granular to facilitate effective control of market risk related activities and provides a continuous overview and understanding of activities undertaken by TFO.

TMO closely monitors impact on the Bank's exposure due to the fluctuations in interest rates, equity prices and FX rates, against the risk limits on a daily basis. Counterparty settlement risk limits on foreign currency operations, Government Securities trading and settlement limits and equity trading limits are monitored on a daily basis. Exceptions if any are reported to IC, ALCO and the Board.

Value at risk

Value at risk ("VaR") is a technique for estimating potential losses on risk positions as a result of movements in market rates and prices over a specified time horizon and to a given level of confidence. The Bank developed VaR models internally to manage and monitor equity price risk and FX risk.

The TMO calculates the equity VaR and Fx VaR in accordance to Basel III guidelines. i.e. for a 99% confidence level and 10-day holding period considering historical data for a period of 365 days, to monitor against the risk appetite of the Bank and reports to DGM-Treasury/TFO on a daily basis. All exceptions are reported to ALCO, IC and to the Board through BIRMC.

Equity VaR against appetite limits – 2018

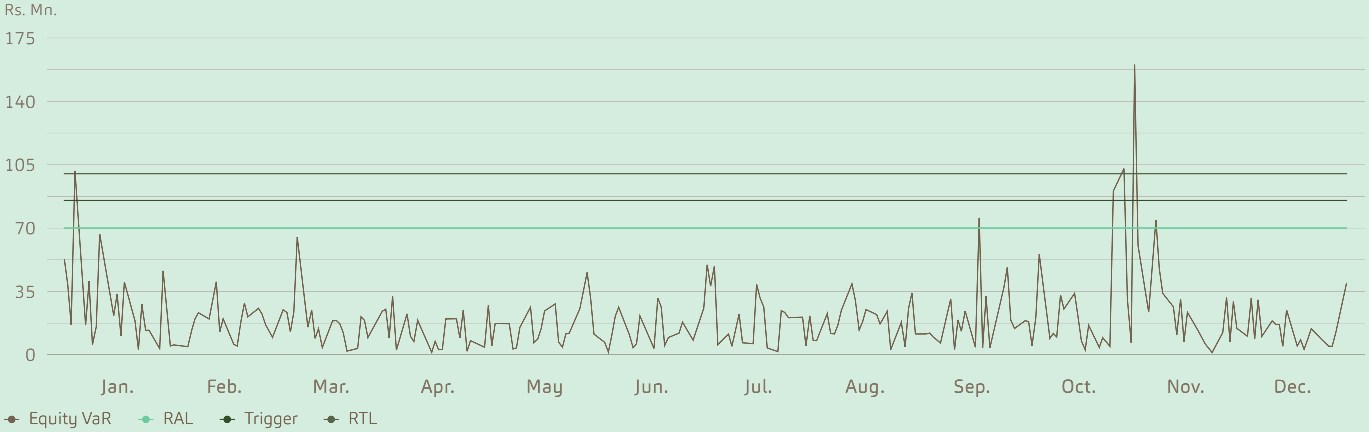


Figure 21

FX VaR – 2018

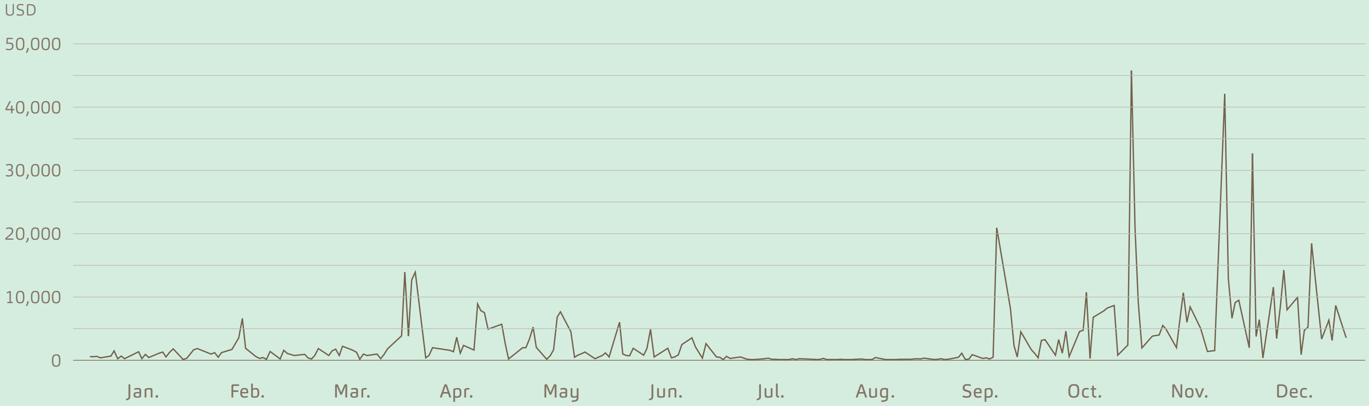


Figure 22

Liquidity risk

Liquidity risk arises when the Bank fails to maintain or generate adequate liquid funds to meet its payment obligations in full as they fall due or only do so at materially disadvantageous terms. The efficient management of liquidity is essential in retaining the confidence of the customers, counterparties, regulator, and other stakeholders. Treasury has the primary responsibility for managing liquidity risk within the predetermined risk appetite of the Bank.

The Bank has maintained appropriate liquidity buffers in line with regulatory and prudential requirements, considering the Bank's risk profile and market conditions.

The control framework for managing liquidity risk is designed to ensure the maintenance of sufficient amount of quality liquidity resources and a funding profile that is appropriate and adequate to meet the liquidity risk appetite. This is achieved through a combination of policy formation, review and governance, analysis, stress testing, limit setting and monitoring which drive the Bank in achieving internal and regulatory liquidity requirements.

Funding diversification by product

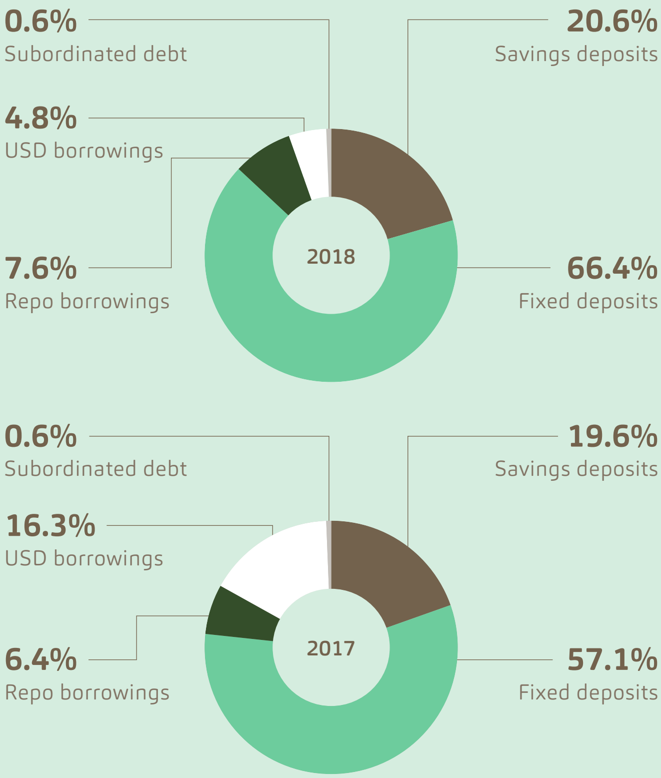


Figure 23

The Bank has access to a wider spectrum of retail deposits and institutional deposits through its branch network and counts on stable funding as the primary source of funds. Alternatively, the Bank has also approached low cost foreign currency borrowing opportunities.

In 2018, total funding related liabilities were amounting to Rs. 965.6 Bn., of which 86.9% consists of deposits, 7.6% of borrowings under repurchase agreements and 4.8% of foreign currency borrowings.

The access to retail deposits (i.e. Savings and FDs) through island wide network of branches enables reducing the funding concentration risk.

Governance structure

At Senior Management level, ALCO oversees the liquidity risk of the Bank. The principle liquidity risk governance document is the Liquidity and Market Risk Management Policy of the Bank approved by the Board.

MRMU monitors liquidity risk using regulatory ratios, prudential ratios and maturity profile of asset and liability. Further, stress tests are performed on a periodic basis considering scenarios of different severities for a liquidity crisis, credit tightening and speed/time to act in a crisis situation.

The stress test results and liquidity ratios are communicated to the ALCO and the Board through BIRMC.

Liquidity risk management process

The Bank manages liquidity in compliance with respective statutory regulations set by the regulator and within the risk appetite framework. Liquidity risk management ensures that the Bank has appropriate amount and diversification to support its obligations at all times.

The Bank manages liquidity risk by monitoring liquidity risk indicators and tools as per Basel III requirements. RMD monitors the funding concentration of the Bank both by significant counterparty and significant product to ensure that funding diversification is maintained across products and to ensure adherence to Board approved risk appetite limits.

Risk Management

Liquidity management process

Tactical (short term) liquidity risk management	Structural (long term) liquidity risk management	Contingency liquidity risk management
Manage intra-day liquidity positions	Ensure a structurally sound financial position	Monitor and manage early warning liquidity indicators
Ensure LCR and NSFR within the risk appetite Monitor inter-bank and repo shortage levels	Identify and manage structural liquidity mismatches	Establish and maintain contingency funding plans
Monitor daily cash flow requirements	Determine and apply behavioural profiling	Undertake regular liquidity stress testing and scenario analysis
Manage short-term cash flows	Manage long-term cash flows	Convene liquidity crisis management committees, if needed
Manage daily foreign currency liquidity	Preserve a diversified funding base	Set liquidity buffer levels in accordance with anticipated stress events
Set deposit rates in accordance with structural and contingent liquidity requirements as informed by ALCO.	Inform term funding requirements	Advise on the diversification of liquidity buffer portfolios
	Assess foreign currency liquidity exposures	Ensure compliance with Basel III liquidity requirements
	Establish liquidity risk appetite	
	Ensure appropriate transfer pricing of liquidity costs	

Table 8

Regulatory ratios →

Statutory Liquid Asset Ratio (SLAR) and Liquidity Coverage Ratio (LCR) are monitored on a monthly basis, whereas the Net Stable Funding Ratio (NSFR) is monitored on a quarterly basis.

The Bank has successfully maintained liquidity requirements under Basel III, LCR in excess of 100% and SLAR in excess of 20% to ensure compliance with the minimum regulatory requirements. This is mainly due to the mandatory requirement to invest 60% of the deposits in Government Securities which are highly liquid.

Bank is well above the regulatory minimum for Basel III NSFR. This is achieved mainly by having a more stable retail deposit base of the Bank.

Liquidity ratios

	December 2018 %	December 2017 %	Regulatory minimum %
SLAR – DBU	**54.88**	73.44	20
LCR – Rupee	**245.06**	377.57	90
LCR – All currency	**321.29**	376.18	90
NSFR	**147.00**	135.45	90

Table 9

Trends in regulatory ratios

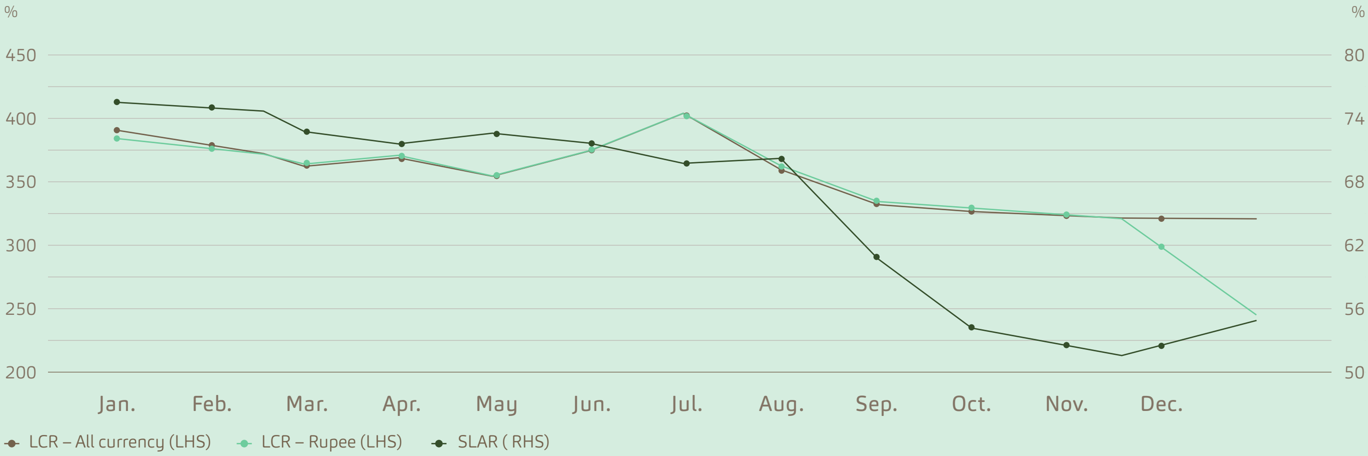


Figure 24

Maturity gap

Bank	Up to 3 months Rs. '000	3-12 months Rs. '000	1-3 year Rs. '000	3-5 year Rs. '000	More than 5 year Rs. '000	Total as at 31.12.2018 Rs. '000
Assets with contractual maturity (interest-bearing assets)						
Cash and cash equivalents	13,528	–	–	–	–	13,528
Placements with banks	8,962,285	8,626,160	–	–	–	17,588,445
Financial assets recognised through profit or loss						
– measured at fair value	526,079	45,164	1,562,229	5,587,752	7,080,240	14,801,463
Financial assets at amortised cost						
– loans and advances	24,859,047	76,313,691	116,389,323	75,402,639	130,567,445	423,532,145
– debt and other instruments	36,694,607	60,416,015	100,748,159	124,717,849	196,371,339	518,947,969
Financial assets measured at fair value through other comprehensive income	93,693	2,417	574,676	1,614,189	148,939	2,433,915
	71,149,238	145,403,447	219,274,387	207,322,429	334,167,963	977,317,466
Other assets (non-interest-bearing assets)						
Cash and cash equivalents	3,420,996	–	–	–	–	3,420,996
Derivative financial instruments	4,740,106	–	–	–	–	4,740,106
Financial assets recognised through profit or loss						
– measured at fair value	469,730	1,409,189	–	–	–	1,878,919
Financial assets measured at fair value through other comprehensive income	–	–	–	–	3,750,515	3,750,515
Investments in subsidiaries	–	–	–	–	1,700,000	1,700,000
Property, plant and equipment	–	–	–	–	13,465,755	13,465,755
Other assets	845,513	9,129,458	8,887,211	6,541,719	5,805,314	31,209,217
	9,476,345	10,538,647	8,887,211	6,541,719	24,721,584	60,165,507
Total assets	80,625,583	155,942,094	228,161,598	213,864,148	358,889,547	1,037,482,973

Risk Management

Bank	Up to 3 months Rs. '000	3-12 months Rs. '000	1-3 year Rs. '000	3-5 year Rs. '000	More than 5 year Rs. '000	Total as at 31.12.2018 Rs. '000
Liability with contractual maturity (interest-bearing liabilities)						
Due to banks	58,368,770	6,718,543	12,031,832	–	–	77,119,146
Financial liabilities at amortised cost						
– due to depositors	425,141,386	396,295,352	13,301,606	4,836,068	–	839,574,411
– due to other borrowers	14,619,083	185,718	–	–	–	14,804,802
Debt securities issued	–	46,389,133	–	6,000,000	–	52,389,133
	498,129,239	449,588,746	25,333,438	10,836,068	–	983,887,492
Other liabilities (non-interest-bearing liabilities)						
Derivative financial instruments	–	–	1,533	–	–	1,533
Retirement benefit obligations	–	–	–	–	3,830,795	3,830,795
Differed tax liabilities	–	–	–	–	582,463	582,463
Other liabilities	2,750,829	875,249	794,715	779,046	247,437	5,447,277
Due to subsidiaries	750	–	–	–	–	750
Stated capital/assigned capital	–	–	–	–	9,400,000	9,400,000
Statutory reserve fund	–	–	–	–	3,227,960	3,227,960
Retained earnings	–	–	–	–	4,622,080	4,622,080
Other reserves	–	–	–	–	26,482,625	26,482,623
	2,751,579	875,249	796,248	779,046	48,393,360	53,595,481
Total liabilities	500,880,818	450,463,995	26,129,686	11,615,114	48,393,360	1,037,482,973

Table 10

Other liquidity monitoring tools

Maturity gap analysis of assets and liabilities enable to foresee adverse liquidity levels. The Bank raised funding requirements during the year by pledging part of the Government Securities portfolio to increase borrowings.

The Bank monitors net loans to total assets ratio, loans to customer deposits ratio, liquid assets to short-term liabilities ratio, purchased funds to total assets ratio, commitments to total loans ratio and ratio of (large liabilities – temporary investments) to (earning assets – temporary investments) to manage the funding and liquidity risks.

Except from liquid assets to short-term liabilities ratio and purchased funds to total assets ratio, other ratios reported a positive trend during the year. Increase in exposure to repo borrowing and increase in institutional deposits, adversely affected the purchased funds to total assets ratio.

Liquidity ratios under stock approach

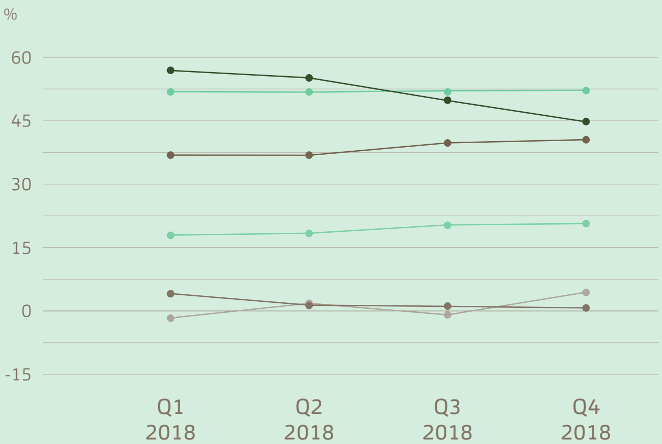


Figure 25

Liquidity contingency plan

Liquidity contingency plan ensures the ability to withstand the Bank specific or market crisis scenarios. Investment of 60% of deposits in Government Securities as per the NSB Act (highly liquid/risk free assets) improves the ability to borrow at lesser cost using fixed income securities as collateral (Repo Borrowings) and high credit rating of the Bank.

MRMU monitors liquidity risk on a frequent basis and provides reports on liquidity indicators and stress testing which will act as early warning to support crisis response strategies.

Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people, and systems or from external events. Operational risk includes legal risk but excludes reputational and strategic risk. The Bank is exposed to a broad range of operational risks through its daily operations.

The Bank is aware of the emerging operational risk concerns. The role of operational risk management is reviewed on a yearly basis considering the impact from existing and emerging trends in operational risks, such as IT disruptions, data compromise, regulatory risk, theft and fraud, outsourcing, model risk etc.

Existing and emerging operational risks

IT disruption	IT disruption can be driven by cyberattack, human error or a failure of aging hardware. The costs from such disruptions are harder to quantify from financial terms and can impact the overall resilience of the Bank. Business Continuity Management System (BCMS) and Disaster Recovery Policy (DRP) are used by the Bank to minimise impacts from IT disruptions. ITSC ensures the availability of up-to-date hardware and software systems with constant uptime and proper maintenance, whereas Information Security Division monitors the effectiveness of the controls in place.
Data compromise	Data can be compromised through cybertheft, unauthorised access, accidental disclosures and employee negligence. The Bank has in place a Board approved Information Security Policy Framework to ensure appropriate actions are taken to ensure the confidentiality of sensitive data and information. Information Security Unit ensures implementation of Policy Framework to minimise vulnerabilities.
Compliance/ Regulatory risk	The scope of regulatory framework will continue to expand globally. Regulatory changes in areas such as capital, leverage, funding and liquidity are expected to have considerable implications to the Bank's risk management process. The regulator and the Government are increasingly demanding banks to comply with both local and global regulatory standards. Since the scope of regulations are expanding substantially, compliance with existing regulations are unlikely to be sufficient. Therefore, NSB is prepared to comply with potential future changes in regulations as well.
Theft and fraud	Theft and fraud is the most common operational risk, with the advancement of technology and digitalisation, focus is made on cyberfrauds. Internal control structure of the Bank acts as the first line of defence to minimise thefts and frauds. During the year, the Bank took several measures to minimise fraud risk from cyberbandits.
Outsourcing	Outsourcing risk emerged due to growing reliance on external service providers/vendors. Several actions are taken to manage the risk from outsourcing such as conducting vendor due diligence, enforcing new Non Disclosure Agreements (NDAs) and reviewing conditions of Service Level Agreements (SLAs).
Model Risk	Increasing dependence on models will require better understanding and managing of model risk. Model errors stem from issues with data quality, technical or implementation issues, and correlation inconsistencies. These are mitigated through sophisticated model development, improving data quality and consistent monitoring of model outputs.

Table 11

Risk review →

Operational risk is reviewed in terms of material risks to the Bank. The Bank has a very low tolerance for operational risks which impact critical functions of the business.

Operational risk review

Risk component	Description	Monitoring/Management tools	Exposure	Impact*
Theft and fraud risk	Fraudulent activities by internal or external party	→ Fraud risk management and whistle-blowing process → Internal controls → KORIs → Loss event monitoring → RCSA	Moderate	Moderate
IT disruption and data security	Failed or inadequate processes, systems and information technology	→ Internal controls → Information Security Management System (ISMS) → BCMS → KORIs monitoring → Incident reporting	High	Moderate
Compliance/ Regulatory risk	Failure in meeting regulatory requirements	→ Compliance programme and examinations → KORIs monitoring → Compliance risk scorecard	Moderate	Moderate
Legal risk	Inadequate/failure to comply with legal requirements	→ Legal clearance on all contractual obligations → KORIs monitoring	Moderate	Low

* Possible impact on earnings and capital in a high stress situation

Figure 26

Governance structure →

The Bank's Operational Risk Management Framework (ORMF) focuses on providing a sustainable operations by addressing the existing and emerging operational risks and describes a formal governance structure.

Following policies supplement operational risk management policy framework:

- Information Security Policy (ISP)
- Business Continuity Management System Policy (BCMSP)
- Fraud Risk Management and Whistle-blowing Policy
- Outsourcing Policy

ORMF is reinforced by the effective governance structure and Senior Management oversight. Responsibility for operational risk management lies with the Board with the assistance of the BIRMC.

Operational risk management structure

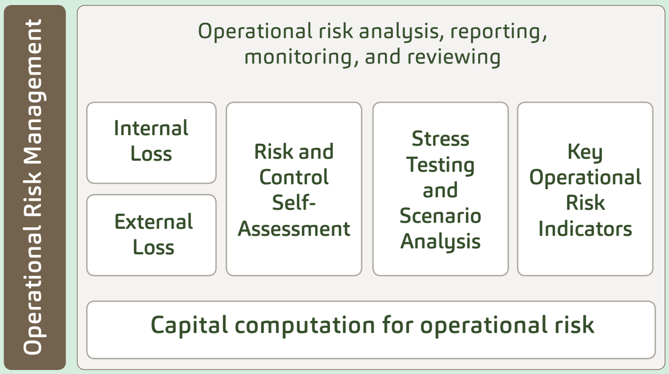


Figure 27

ORMC is the Management Committee dedicated to oversee the operational risk management. Responsibility of designing, implementing, and continuous reviewing of the ORMF lies with the Operational Risk Management Unit (ORMU) of RMD. The responsibilities of ORMU include:

- Reviewing/updating policies
- Operational risk assessment using RCSA, KORIs and loss event data
- Monitoring implementation of BCMS
- Monitoring ISMS
- Monitoring the risk of outsourcing activities
- New products/process reviews
- Reporting to ORMC and Board through BIRMC

Operational risk management process

The Bank takes a comprehensive approach to manage operational risk in all operational areas. Operational risk derives from people, processes and systems in the Bank's operations and/or from external events.

Operational risk profile is defined in comparison to the Bank's risk appetite and risk management is practised and made part of the risk culture of the Bank. Effectiveness of the processes depends on the commitment of all levels including the Board and the Senior Management.

Branches and divisional staff are the primary owners of operational risk. They are provided with adequate training which assist in identifying inherent risks in their area of responsibility. System controls, access controls, segregation of duties, clear lines of authority and responsibility, dual checks through authorisation and verification of transactions, physical controls over assets, proper record keeping, reconciliations, audit trails and audit logs are parts of the internal control structure, which is the base for operational risk management.

ORMU of the RMD identifies the risks with the intention of implementing corrective actions to address process and control deficiencies.

The Bank uses different tools and techniques to manage and minimise operational risk exposures.

Loss event data collection and analysis

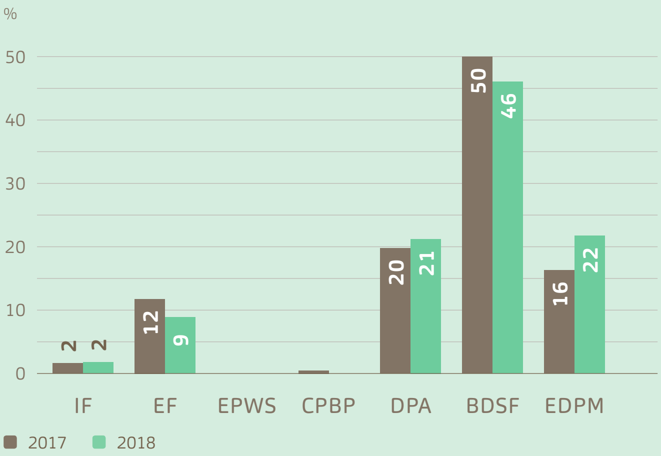
Basel Accord defines the loss data base as a key component of sound operational risk management and one of the criteria to be met for being eligible to use advanced capital calculation models.

The Bank's loss event data collection process captures both internal and external loss event data. The Bank has a documented procedure for identification, collection and recognition of internal loss data from all geographic locations to facilitate timely regulatory reporting and recognition. Further, the Bank's external loss event data base captures operational loss events published by similar institutions.

Collected data is classified into Basel Level II loss event categories and analysed to identify the nature, root causes and the probability of occurrence to take process improvements, and risk mitigation actions.

In the year 2018, there was a high frequency of business disruptions and system failures which is inherent to a service provider in an automated environment. Internal frauds reported the highest severity during the year. Apart from the internal controls in place, the Bank has in place a fraud risk management and whistle-blowing process to manage fraud risk.

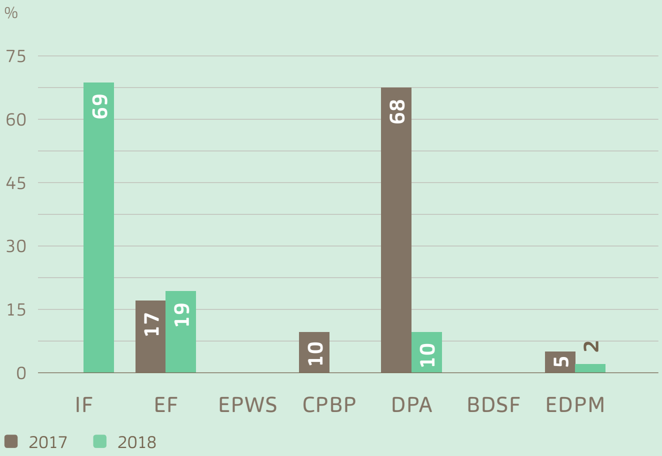
Frequency of loss event data



IF – Internal Fraud
EF – External Fraud
EPWS – Employment Practices and Workplace Safety
CPBP – Clients, Products and Business Practices
DPA – Damage to Physical Assets
BDSF – Business Disruption and System Failures
EDPM – Execution, Delivery and Process Management

Figure 28

Severity of loss event data



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CPBP – Clients, Products and Business Practices
DPA – Damage to Physical Assets
BDSF – Business Disruption and System Failures
EDPM – Execution, Delivery and Process Management

Figure 29

Operational losses for the financial year 2018 was 0.16% of the average audited gross income for last three years, which is far below the internal alert level. The trend line demonstrates the Bank's consistency in maintaining losses at minimal levels over the last five year period.

Actual operational losses against risk appetite and tolerance limit

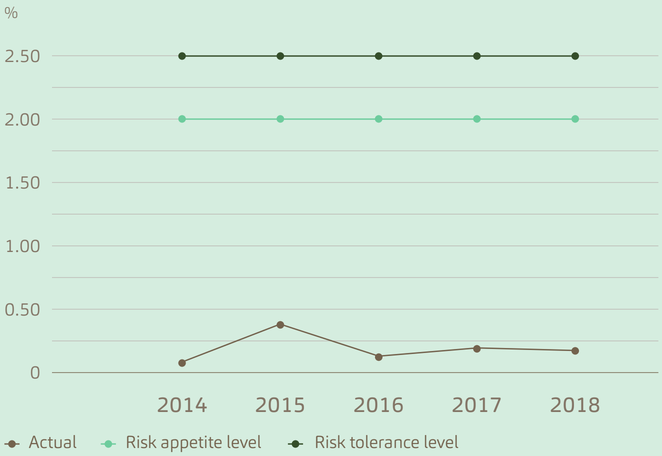

Figure 30

Key operational risk indicators monitoring

KORIs are used to enhance the risk monitoring and risk reporting as those demonstrate the changes in risk factors in terms of frequency and impact. KORIs measure the potential risk related to a specific action and act as an early warning system to alert the Bank's financial, operational, reputational, compliance, or strategic issues.

The Bank's KORIs dashboard covers key business operations and support services of the Bank to identify and assess operational risk profile in a risk matrix covering Audit Issue Management, Business Continuity Management, Information Security Management, Product Quality, Process Quality and Compliance. KORIs are defined under each area to assess the risk based on predefined threshold limits. These threshold limits are revised annually or more frequently considering the changes in operational environment.

ORMU monitors the operational risk profile using KORIs and reports to ORMC and the Board through BIRMC.

Risk and control self-assessment

RCSA forms an integral element of the overall operational risk framework, as it provides an opportunity to the Bank to integrate and coordinate its risk identification and risk management efforts to improve understanding, control and oversight of its operational risks. Underlying assumption in RCSA is that, business process owners (First Line of Defence) are in a best position to understand their own risks. This helps in raising awareness on risks that need immediate attention and to prioritise addressing operational weaknesses in a structured manner.

RMD Coordinates with the process owners to conduct RCSA in critical functions to identify process level risks and to update the Risk Register of the Bank at process level.

Customer complaints management

Customer complaint management process of the Bank includes recording and responding within the benchmark time upon receipt of a complaint to ensure an effective customer service.

ORMU considers customer complaints as a source of identifying operational weaknesses and risks in the Bank's operations. Customer complaint data are analysed periodically and relevant findings are reported to ORMC to take further risk mitigation actions.

New product and process risk assessment →

The Bank has a streamlined process for new product launching and reviewing of the existing products. This process ensures minimising of operational risk involved in the product and the related operational activities.

ORMU assesses the operational risk from new products, channels and processes prior to introducing/implementing them within the Bank. Post-introduction/implementation reviews are conducted by the ORMU to further minimise the operational risks.

Information security risk management →

Technological advancements within the financial service systems has changed the Bank's business model to a greater extent. Information security management governance framework stipulated in Board-approved ISP provides the background to establish a safe banking service to customers in terms of accuracy, control, integrity, and confidentiality of the information.

Internally the Bank has put in place a Board-approved ISP to protect the Bank's critical information assets.

Accordingly, NSB's improved ICT infrastructure and procedures ensure the Information Security Risk Management in prudent manner.

Further steps are taken to comply with the Baseline Security Standards (BSS) and to obtain ISO certification in ISMS (ISO 27001:2013) with the assistance of industry expertise. This process is undertaken by Information Security Unit, monitored through the ITSC and ORMC.

Key areas of information security risk management process

Figure 31

Business continuity management system →

BCMSP recognises that products, operations and IT enable services must be continuously delivered without interruption. Business continuity management framework approved by the Board addresses resources and information needed to deal with emergencies such as natural disasters, accidents, power and energy disruptions, communications, transportation, safety and service sector failure, environmental disasters such as pollution and hazardous materials spills, cyberattacks and hacker activities.

Periodical testing of the same will enable to recap weaknesses of the existing plan for further improvements. BCMS minimises financial, operational, and reputational losses to the Bank.

Business continuity management process

Figure 32

Risk Management

Risk transfer

Outsourcing is used as an effective cost saving and a risk transfer strategy. The Bank's outsourcing operations are conducted in accordance with the Board approved outsourcing policy and other regulatory requirements.

The risk arising from outsourcing of business operations are managed by the Outsourcing Monitoring Unit of the Administration Division.

The Bank conducts comprehensive due diligence exercises to ensure the service providers' capability to perform the activities outsourced. ORMC monitors the effectiveness of the outsourcing function and risk management practices conduct by the Administration Division.

Insurance plays a key role as an operational risk mitigant to transfer key insurable risk to an insurance service provider. Insurance policies are used to cover "low frequency high impact" events such as damage to physical assets due to natural disasters and fraudulent activities etc.

The adequacy of the insurance policies are continuously reviewed considering the existing and emerging risks to the Bank. Insurance function is centralised within the Administration Division. Effectiveness of insurance processes are monitored by ORMC.

Legal risk

Basel Accord defines legal risk as a part of operational risk. Legal risk includes, but not limited to risk of losses due to inaccurately drafted contracts and their execution, absence of written agreements or inadequate agreements resulting in fines, penalties, and punitive damages. Legal risk is managed through:

- Ensuring all applicable laws are fully taken into consideration in business operations when entering into contractual relationships with third parties such as customers or service providers
- Ensuring all such contractual relationships are supported by required documentation
- Establishing mechanisms to ensure conformity to laws and regulations when introducing/reviewing products and processes.

The responsibilities of managing legal risk is delegated to the business owners with the guidance of Legal Division. Legal Division engages in strategic management of legal risk of the Bank.

ORMU monitors the plausible operational loss events arising due to legal processes and systems on a periodical basis and reports to ORMC.

Compliance risk

Compliance risk is directly resulted from non-compliance with applicable laws and regulations, code of conduct, and standards of practice in the banking industry. As such, the Compliance Division headed by the Compliance Officer directly reports to the Board through BIRMC and takes measures to mitigate the compliance risk of the Bank.

Compliance risk management process

Figure 33

Reputational risk

Reputation risk is the risk of adversities to earnings or solvency of the Bank due to negative stakeholder perception on business practices and financial condition. Management of reputational risk is highly important for financial institutions to maintain the public confidence in its operations. Reputational risk is broadly managed through systems and controls adopted for all other risks as reputational risk is driven by a wide range of other business risks which are managed by the policies, procedures, code of conduct, and business ethics.

The Bank has a zero risk appetite for reputational losses. Thus, RMD closely monitors the reputational vulnerabilities using tools such as KORIs, and customer complaint analysis. A Scorecard based model is used to assess the reputational risk within the ICAAP.

Strategic risk

Strategic risk can be considered as the risk of loss arising due to unsuccessful business plan or inability to implement suitable business plan, failure to respond promptly to the changes in the business environment and inadequate resource allocation causing adverse impact on earnings and capital of the Bank. Missing out on potential upside opportunities can also be considered under strategic risk.

Responsibility for strategy development rests with the divisional heads through the strategic planning and budgeting process which aligns NSB's vision, mission and the risk appetite. Strategic risk could arise due to worsening of general economic and market conditions locally and globally. The inputs from the Research Division are incorporated in formulating business strategies for the Bank.

The Board has the oversight responsibility towards the strategic risk of the Bank, which is monitored by the Senior Management through frequent reviews. A scorecard based model is used to assess the strategic risk within the ICAAP.

Capital management

The Bank requires a strong capital position in order to satisfy regulatory capital requirements, provide financial security to its depositors/creditors, maintain leeway for future business expansion and generate adequate return to its shareholders.

Shareholders' equity includes ordinary shares issued to the Government of Sri Lanka, retained earnings and reserves. The shareholders' equity increased by Rs. 2.7 Bn. during the year which was transferred from unclaimed deposits reserve.

Managing capital is an integral part of the risk management framework to assure resilience of the Bank while generating shareholder return. Capital management process is in line with the guidelines issued by the CBSL.

Minimum capital requirements and buffers – Pillar I

The Banking Act Direction No. 01 of 2016, introduced capital requirements under Basel III for licensed banks commencing from 1 July 2017 with specified timelines to increase minimum capital ratios which is to be fully implemented by 1 January 2019.

The Bank achieved the regulatory minimum requirements for capital adequacy during the year 2018. Common Equity Tier 1 (CET1) ratio increased during the year to 13.32% as at 31 December 2018, from 11.93% reported as at 31 December 2017. In the absence of qualifying additional Tier 1 capital instruments, the Bank's CET1 ratio is equal to Total Tier 1 Capital ratio.

The Bank took initiatives to monitor and maintain the Risk-Weighted Assets (RWA) within the risk appetite levels. Total Capital ratio increased to 16.14% as at 31 December 2018 against 15.31% reported as at 31 December 2017.

The Bank's subsidiary, NSB Fund Management Company contributes positively to the CAR at Group level. At Group level, CET 1/Tier 1 Ratio is 14.14% and Total Capital ratio is 16.88% as at 31 December 2018.

Composition CET1/Tier 1 and Total Capital

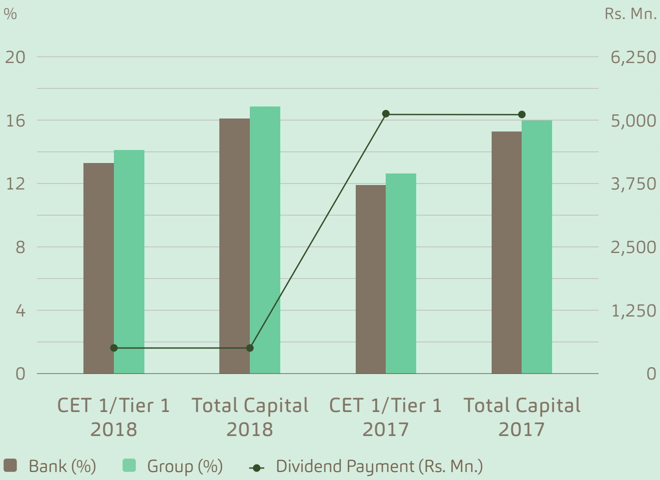

Figure 34

Risk Management

The Bank's total CAR is below the risk appetite level during the year 2018. As the 100% State Owned savings bank, there are limited options available to raise capital externally. The only regulatory capital instrument available under Basel III is the shares issued to the Government of Sri Lanka.

According to the National Savings Bank Act No. 30 of 1971, the Bank cannot raise Tier 2 capital that fulfils criteria to qualify as regulatory capital under the Basel III guidelines. Hence, the prime source to augment the capital is retained earnings. The main reasons for not achieving the target level of capital is the reduction in profit levels due to the economic and market conditions that prevailed and the legislative change.

The removal of Withholding Tax (WHT) deduction on interest/discount paid to any person on Security or in Treasury Bond or Treasury Bill in new Inland Revenue Act No. 24 of 2017 and the introduction of "Debt Recovery Levy" in Finance Act No. 35 of 2018 caused a significant adverse impact on the profitability of the Bank.

Considering the prevailing capital constraints, the Bank strives to manage capital more efficiently by achieving the optimum balance between performance and risk and conduct stringent monitoring of the RWA mix, and changes in the risk profile.

The Bank has intimated the stakeholders on the increased demand for capital imposed by Basel III and with the intention to obtain stakeholder backing to improve capital level.

Internal Capital Adequacy Assessment Process – Pillar II

The ICAAP comprises risk appetite, stress testing, and capital planning concepts along with a sound risk management framework to capture all material risks. This enables combining the business performance, risk management action and risk sensitive capital in a more rational manner to establish a level of internal capital commensurate with the Bank's risk profile.

Board approved ICAAP Policy is in line with the CBSL directions on Basel III Pillar II issued to banks on conducting Supervisory Review and Evaluation Process (SREP) and international best practices.

The Bank's ICAAP is governed by four principles which are fundamentals for the Bank and the regulator. The process involves integrating risk to decision making, comprehensive risk assessment, reviewing of internal controls, monitoring, reporting and stress testing risks with the oversight responsibility of the Board.

Risk assessment captures both Pillar I and Pillar II risks. Pillar I risks deal with regulatory capital requirements whilst Pillar II risks deal with economic capital. The Bank uses both qualitative and quantitative approaches to assess Pillar II risks.

Regulatory ratios – Actual vs. regulatory minimum

	Actual as at 31 December 2018		Actual as at 31 December 2017				
Ratios (%)	**Bank**	**Group**	Bank	Group	Regulatory minimum 1 December 2017	Regulatory minimum 1 December 2018	Regulatory minimum 1 December 2019
CET1 plus CCB and capital surcharge for D-SIBs	**13.32**	**14.14**	11.93	12.65	6.25	7.375	8.50
Tier1 plus CCB and capital surcharge for D-SIBs	**13.32**	**14.14**	11.93	12.65	7.75	8.875	10.00
Total capital plus CCB and capital surcharge for D-SIBs	**16.14**	**16.88**	15.31	16.00	11.75	12.875	14.00

Table 12

ICAAP promotes an integrated approach, combining risk management practices and strategic business planning to gain operational efficiencies, growth and solvency.

According to the ICAAP assessments, the Bank identified the capital requirement to cover the total risk profile of the Bank. Comprehensively documented ICAAP is discussed and approved by ALCO and the Board through BIRMC prior to submitting to the regulator.

Stress testing

Stress testing is an integral part of ICAAP process. The stress testing framework is governed by the Board approved stress testing policy and guidelines issued by CBSL. NSB's Stress Testing framework includes stress tests on all the material risks such as credit risk, interest rate risk in trading book and banking book, operational risk, liquidity risk, concentration risk and residual credit risk. The Bank has defined three levels of increasing adversity, i.e. minor, medium and major (or Low, Medium and High) for the stress testing purposes.

Stress testing provides understanding on ability of the Bank to withstand unforeseen scenarios of varying severity under adverse economic, political, and physical changes in the environment in which it operates. The Bank uses several stress testing techniques, such as scenario analysis, and sensitivity analysis.

The Bank uses sensitivity analysis to measure the impact of individual market factor movements on specific instruments or portfolios, including interest rates, foreign exchange rates and equity prices, such as the effect of a one basis point change in yield. This is mainly used to identify the impact on trading and banking books due to adverse interest rate fluctuations and reports are submitted to ALCO on a periodic basis. These reports are instrumental in asset and liability management, and pricing decisions of the Bank.

Sensitivity analysis – Assessment of yield curve risk in trading book – Government securities

Rs. '000	FVTPL	FVOCI	Total
Unrealised gain/(loss) of G sec portfolio against cost at the end of 2018	(702,478.65)	(117,010.39)	(819,489.05)
Change in M2M value			
100 bps increase in yield	(547,129.69)	(74,284.90)	(621,414.59)
200 bps increase in yield	(1,065,131.10)	(145,527.81)	(1,210,658.92)
100 bps decrease in yield	578,282.40	77,476.61	655,759.01
200 bps decrease in yield	1,189,918.70	158,305.09	1,348,223.79

Table 13

Sensitivity analysis – Interest Rate Risk in Banking Book (IRRBB)

100bp rate shock on negative gaps		Up to 1month	1-3 months	3-6 months	6-12 months	1-3 years	3-5 years	Over 5 years	Total
Stand-alone level	RSA/RSL Gap	(188,326)	(234,376)	(132,203)	(176,260)	193,941	196,486	334,168	(6,570)
	Impact on NII (Rs. Mn.)	(1,806)	(1,958)	(833)	(459)	–	–	–	(5,056)
Consolidated level	RSA/RSL Gap	(191,670)	(246,064)	(127,679)	(177,213)	199,789	202,650	336,017	(4,170)
	Impact on NII (Rs. Mn.)	(1,838)	(2,056)	(805)	(461)	–	–	–	(5,160)

Table 14

The results obtained from stress testing exercise is used to identify what might go wrong, how it might go wrong and how badly it affect the Bank. Analysis carried out based on stress testing results are reported to the process owners, management committees and BIRMC/Board to support proactive decision making.

Stress testing is also used as a tool to facilitate setting up risk appetite and tolerance limits, strategic planning, and capital planning.

Impact to the capital adequacy at different stress levels

Risk area	Scenario	Impact to CAR Low %	Impact to CAR Medium %	Impact to CAR High %
Credit risk	Credit risk – Increase in PD due to an economic down turn (Low 10% Medium 20% High 30%)	(0.12)	(0.24)	(0.36)
Market risk	Interest rate risk: Increase in market yield Low Assets 200bps, Liabilities 100bps Medium Assets/Liabilities 200bps High Assets 100bps, Liabilities 200bps	(7.67)	(11.74)	(12.12)
	Equity price risk: Decline in market prices (Low 10%, Medium 20%, High 30%)	(0.21)	(0.42)	(0.63)
	FX risk: LKR depreciation (Low 10%, Medium 15%, High 20%)	0.05	0.07	0.09
Operational risk	Increase in operational losses classified under Basel II loss event categories	(0.02)	(0.03)	(0.05)

Table 15

Minimum disclosure requirements – Pillar III

Minimum disclosure requirements were introduced by the CBSL within the Basel III Framework to allow the market participants to gauge the capital adequacy and risk exposures of the Bank.

Refer page 389 to 401 for minimum disclosure requirements as per Banking Act No. 1 of 2016.

Future Outlook

Considering the upcoming challenges and risks in the banking operations and industry, NSB continues to strengthen Integrated Risk Management Framework to cover broad spectrum of emerging and existing risks.

Initiatives will be taken within the SBP to enhance customer service delivery by upgrading IT systems which will facilitate further strengthening of the internal control structure and risk management practices in compliant with the best practices in risk management and regulatory requirements.

Financial Reports

Financial Calendar

Financial Calendar 2018

Publication of Interim Financial Statements for the quarter ended 31 March 2018	31 May 2018
Publication of Interim Financial Statements for the quarter ended 30 June 2018	29 August 2018
Publication of Interim Financial Statements for the quarter ended 30 September 2018	29 November 2018
Publication of Financial Statements (Audited) for the quarter ended 31 December 2018	28 March 2019

Proposed Financial Calendar 2019

Publication of Interim Financial Statements for the quarter ended 31 March 2019	31 May 2019
Publication of Interim Financial Statements for the quarter ended 30 June 2019	30 August 2019
Publication of Interim Financial Statements for the quarter ended 30 September 2019	29 November 2019
Publication of Financial Statements (Audited) for the quarter ended 31 December 2019	31 March 2020

Annual Report of Board of Directors

General

The Directors of the National Savings Bank have pleasure in presenting their Integrated Annual Report on the affairs of the Bank together with the Audited Financial Statements of the Bank and Consolidated Financial Statements for the year ended 31 December 2018. We ascertain that it gives the strategic picture of the Bank's business that explains how the Bank creates and sustains value over the years and in the future.

The Annual Financial Statements reviewed and recommended by the Board Audit Committee (BAC) were approved by the Board of Directors on 14 March 2019. The Audited Financial Statements were authorised to be issued on 14 March 2019. The Report also includes certain disclosures required to be made under the Banking Act No. 30 of 1988 and amendments thereto and the Banking Act Direction No. 12 of 2007 on Corporate Governance for Licensed Specialised Banks issued by the Central Bank of Sri Lanka (CBSL) and subsequent amendments thereto. The Annual Report and Financial Statements, together with the Auditor General's Report will be submitted to the Minister of Finance, on or before 31 May 2019 as per Circular No. PED/27 of 27 January 2005, issued by the Director General of the Department of Public Enterprises to be placed before the Parliament of Sri Lanka.

National Savings Bank is incorporated in Sri Lanka by National Savings Bank Act No. 30 of 1971 and was granted the status of Licensed Specialised Bank in terms of Banking Act No. 30 of 1988. The Bank has been assigned AA+(lka) long-term credit rating by the Fitch Rating Lanka (Pvt) Ltd. It has also been awarded international credit ratings of B stable by Fitch Inc. and B stable by Standard and Poor's Rating services.

Review of business

Principal activities of the Bank

The principal activities of the National Savings Bank is promotion of savings among the people of Sri Lanka and profitable investments of savings so mobilised. Accordingly, during the year under review, the principal activities of the Bank were, retail banking, corporate banking, trade financing, treasury dealing and investments, correspondence banking and money remittance facilities, pawning, foreign currency operations and other financial services.

Vision, Mission, and Values

The Bank's Vision, Mission, and Values are given on the inner cover of this Annual Report. All permanent employees are being abided by the Code of Conduct of the Bank and the Government Oath with the view of maintaining the highest ethical standards in achieving the Vision and Mission of the Bank.

Government guarantee

The Government of Sri Lanka guarantees the repayment of the monies deposited with the Bank together with interest thereon.

Subsidiary of the Bank

Subsidiary NSB Fund Management Company Ltd., is the Bank's only Subsidiary and the principal activity of the company is dealing in Government Securities as a primary dealer authorised by the Central Bank of Sri Lanka. Details of the transactions are given in Note 47 (b) to the Financial Statements.

Changes to the group structure

The Bank invested an additional Rs. 800 Mn. in Subsidiary during the year 2018 and there were no significant changes in the nature of the principal activities of the Bank and the Group.

Review of business performance

The overall review of financial performance of the Bank and the Group for the financial year 2018 are provided in the Chairman's Message (page 10), General Manager/CEO's Review (page 12). The "Management Discussion and Analysis" on pages 65 to 128 and Audited Financial Statements (page 248) provides a comprehensive review on key business lines and the state of affairs of the Bank and the Group. These reports form an integral part of the Annual Report.

Branch network expansions

Widening the Bank's presence in the island, two branches were added to the network during the year under review. At the end of the year the Bank has 255 branches in its network. The ATM network was further expanded enhancing customer convenience. The Bank installed 24 ATMs (21 CRMs and 3 ATMs) during the year across the island bringing out the total ATMs to 310 excluding peer banks' ATMs through which customers of NSB can transact.

Preparation of Financial Statements

The Financial Statements are prepared in accordance with the Sri Lanka Accounting Standards (SLFRSs/LKASs) laid down by The Institute of Chartered Accountants of Sri Lanka and comply with the requirements of Banking Act No. 30 of 1988 and amendments thereto and regulatory requirements inclusive of specific disclosures. The Financial Statements of the Bank and the Group for the year ended 31 December 2018 duly certified by the Deputy General Manager – Finance and Planning and approved and signed by the General Manager/ CEO and two Directors including Chairman of the Bank are given on page 248 which form an integral part of the Annual Report of the Bank.

Accounting Policies and changes during the year

The Bank and the Group prepared its Financial Statements in accordance with Sri Lanka Accounting Standards (SLFRSs/LKASs). The Bank and the Group have adopted SLFRS 9 – "Financial Instruments", SLFRS 15 – "Revenue from Contracts with Customers" and SLFRS 7 – "Financial Instrument Disclosure" (amendments) from 1 January 2018. Due to the transition method chosen by the Bank and the Group in applying SLFRS 9, comparative information has been restated to reflect its requirements. The accounting policies adopted in preparation of Financial Statements are given on pages 258 to 276 in this Report.

Directors' responsibilities for financial reporting

The Directors are responsible for the preparation of the Financial Statements that will reflect a true and fair view of the state of affairs of the Bank as at 31 December 2018 and its profit for the year then ended. The Directors are of the view that the Financial Statements appearing on pages 248 to 257 have been prepared in conformity with the requirements of the Sri Lanka Accounting Standards (SLFRSs/ LKASs) and the Banking Act No. 30 of 1988 and its amendments, the NSB Act No. 30 of 1971 and amendments thereto. The Statement of Directors' Responsibility for Financial Reporting appearing on page 236 of this Annual Report describes in detail the Directors' responsibilities in relation to Financial Statements, which form an integral part of the Annual Report of the Board of Directors.

Auditors' Report

The Auditor General had carried out the audit of the Financial Statements of the Bank and the Consolidated Financial Statements of the Group for the year ended 31 December 2018. In 2018, the continuous audit was carried out throughout the year for the Bank and the NSB Fund Management Company Ltd. Issues identified in their reports were submitted to the Management regularly for prompt action. Having confirmed the accuracy of the financial reporting, the Financial Statements, together with the necessary data and information were made available to the Auditor General for examination. The Auditor General's opinion on the Financial Statements appears on page 245 of this Annual Report.

Future developments

An overview of the future developments of the Bank is given in the Chairman's Message (page 10), General Manager/ CEO's Review (page 12) and the "Management Discussion and Analysis" on pages 65 to 128 in Integrated Annual Report 2018.

Gross income

The gross income of the Bank for 2018 was Rs. 111,902 Mn. (2017 – Rs. 107,996 Mn.) while the Group's income was Rs. 112,760 Mn. (2017 – Rs. 108,235 Mn.). Analysis of the gross income are given in Note 3 to the Financial Statements.

Dividends and reserves

Results and appropriation

The profit before income tax of the Bank and the Group amounted to Rs. 7,941 Mn. and Rs. 7,944 Mn. (2017 – Rs. 14,135 Mn. and Rs. 13,751 Mn.) respectively.

The profit after tax of the Bank and the Group stood at Rs. 4,500.1 Mn. and Rs. 4,500.2 Mn. respectively (2017 – Rs. 9,716.0 Mn. and Rs. 9,156.4 Mn.). Details of profit relating to the Bank are given in the following table:

	2018 Rs. Mn.	2017 Rs. Mn.
Profit for the year after payment of all expenses and providing for depreciation, expected credit losses and contingencies before VAT, NBT, DRL and income tax	**11,171**	17,629
VAT on financial services	**2,578**	3,083
NBT on financial services	**344**	411
Debt repayment levy (DRL)	**308**	–
Provision for income tax	**3,441**	4,419
Net profit after tax	**4,500**	9,716
Other comprehensive income for the year, net of tax	**(1,320)**	2,693
Total comprehensive income for the year	**3,180**	12,409

	2018 Rs. Mn.	2017 Rs. Mn.
Appropriations:		
Transfer to statutory reserve	**(225)**	(480)
Contribution to the National Insurance Trust Fund (NITF)	**(45)**	(96)
Contribution to the Consolidated Fund/dividend	**(500)**	(5,111)
Transfers to reserves	**2,410**	6,722

Provision for taxation

The Income Tax Rate applicable for the Bank on its operation is 28%, the Bank's operations are liable for Value Added Tax (VAT) at the rate of 15% and Nation Building Tax (NBT) at the rate of 2% on financial services. The Bank is also liable for debt repayment levy (DRL) at 7% on financial services with effect from 1 October 2018.

The Bank provided deferred tax on all known timing differences under the liability method in accordance with Sri Lanka Accounting Standard (LKAS 12) – "Income Taxes". Information of income tax expenditure and deferred taxation are given in Notes 13 and 29 respectively on pages 286 and 317.

Dividends, taxes and levies/contribution to the Nation

The Bank contributed Rs. 7,536 Mn. by way of taxes and levies to the Government in 2018 (2017 – Rs. 13,440 Mn.). This consisted of:

	2018 Rs. Mn.	2017 Rs. Mn.
Income tax	**3,441**	4,419
Value added tax	**2,578**	3,083
Nation building tax	**344**	411
Special fee	**320**	320
Debt repayment levy	**308**	–
Contribution to the Consolidated Fund	**500**	5,111
Contributions to National Insurance Trust Fund	**45**	96
Total contribution to the Nation	**7,536**	13,440

Reserves

The total reserves of the Bank stood at Rs. 34,333 Mn. as at 31 December 2018 (2017 – Rs. 32,396 Mn.). The Bank's reserves consist of:

	2018 Rs. Mn.	2017 Rs. Mn.
Statutory reserve fund	**3,228**	3,003
Revaluation reserve	**7,793**	7,793
Retained earnings	**4,622**	1,103
Other reserves	**18,690**	20,497
Total reserves	**34,333**	32,396

Information on changes of reserves is given in the Statement of Changes in Equity on page 252.

Service charges to Postmaster General (PMG)

Service charges to the PMG for 2018 amounting to Rs. 147 Mn. has been provided for on the same basis as in 2017.

Retirement benefits and obligations

The Bank maintains two pension funds namely: Staff Pension Fund I and Staff Pension Fund II. Further the Bank maintains a Widows'/Widowers' and Orphans Pension Fund as well as a post-employment medical scheme. Details are given on pages 322 to 330 in Notes to the Financial Statements.

Property, plant and equipment and capital expenditure

The total net book value of property, plant and equipment of the Bank and the Group as at the year end 2018 was Rs. 13,466 Mn. and Rs. 13,469 Mn. respectively (2017 – Rs. 12,396 Mn. in the Bank and Rs. 12,399 Mn. in the Group). Details are given in Notes to the Financial Statements as follows:

- Note 26 to the Financial Statements: Property, plant and equipment on page 310.
- Note 28 to the Financial Statements: Goodwill and intangible assets on page 316.
- Note 46.1 to the Financial Statements: Capital commitments on page 336.

Annual Report of Board of Directors

The total capital expenditure incurred by the Bank on the acquisition of property, plant and equipment and Intangible Assets (including capital work-in-progress) during the year amounted to Rs. 2,067 Mn. (2017 – Rs. 1,109 Mn.) and Group amounted to Rs. 2,067 Mn. (2017 – Rs. 1,111 Mn.), the details of which are given in Notes 26. (a) and 26. (b) to the Financial Statements on pages 312 to 314 of this Annual Report.

Market value of freehold property

The Bank carried out a revaluation on entire class of freehold land and buildings of the Bank in December 2017 by professionally qualified independent valuers and brought in to the Financial Statements in the same year. The revaluation process was carried out as per the Central Bank of Sri Lanka Direction No. 1 of 2014 on "Valuation of Immovable Property of Licensed Specialised Banks". The Board of Directors is on the view that revalued amounts are not in excess of the current market values.

Stated capital and shareholding

Stated capital

The authorised share capital of the Bank is Rs. 10 Bn. which is made of one billion ordinary shares of Rs. 10.00 each. The Bank has issued 270 million ordinary shares of Rs. 10.00 capitalising unclaimed deposit reserve to the Secretary to the Treasury on 31 December 2018. The issued share capital of the Bank as at 31 December 2018 stood at Rs. 9.4 Bn. (2017 – Rs. 6.7 Bn.) The Secretary to the Treasury in his official capacity holds the entirety of the issued share capital. The details are given in Notes 41 and 44 to the Financial Statements on page 332 and 333 of this Annual Report.

Shareholding

The Government of Sri Lanka is the sole shareholder of the National Savings Bank.

Borrowed capital

The Bank issued an international bond for a value of USD 250 Mn. in September 2014. This is in addition to the Bond of USD 750 Mn. issued in September 2013 which matured by September 2018. This was the highest amount of foreign funds raised in a single issue by a bank so far from foreign investors. Information of borrowed capital is given in Note 35.1 respective on page 321 of this Annual Report.

Issue of subordinated debenture

Subordinated liabilities of the Bank as at 31 December 2018 consisted Rs. 6 Bn. rated, unsecured subordinated and redeemable debentures of Rs. 100.00 issued on 29 December 2016 on private placement. This debenture is eligible for the Tier 2 Capital of the Bank. The details of debentures outstanding as at the date of financial position are given in Note 35.2 of the Financial Statements on page 322 to on subordinated liabilities.

Foreign currency borrowing

The Bank has obtained a term loan of USD 100 Mn. from Commerzebank Finance and Covered Bond S.A. in October 2018. The details of the foreign currency borrowing is given in Note 31.1 of the Financial Statements on page 319.

Share information

The basic earnings per share and net assets value per share of the Bank 2018 were Rs. 6.72 (2017 – Rs. 15.67) and Rs. 46.52 (2017 – Rs. 58.35) respectively for the period under review. The details are given in Note 14 on weighted average number of ordinary shares for basic and diluted earnings per share on page 288 and Note 48 on net assets value per ordinary share on page 341.

Corporate social responsibility

The programmes carried out under the Corporate Social Responsibility (CSR) are detailed on pages 106 to 119 in this Annual Report.

Board of Directors

Information of the Directors during the year 2018

The Board of Directors comprises seven Directors including the Chairman and two ex officio members representing the Ministry of Finance and the Postmaster General as per the Section 11 (1) of the NSB Act No. 30 of 1971 as amended by Act No. 28 of 1995. The Minister of Finance appoints the Chairman and other four Directors.

Annual Report of Board of Directors

The following were the Directors during the year 2018.

Name	Date of appointment	Membership status
Mr R M P Rathnayake, Chairman (up to 19 February 2019)	19 November 2018	NED/NID
Mr Aswin De Silva, Chairman (up to 12 November 2018)	9 February 2015 (Assumed duties on 4 March 2015)	NED/NID
Mr D L P R Abeyaratne, Director (Ex officio Director) (up to 11 July 2018)	9 February 2012 (Acting Chairman from 23 May 2012 to 5 August 2012) Reappointed on 10 March 2015	NED/NID
Mr S Naullage, Director (up to 31 December 2018)	9 February 2015	NED/NID
Mr Ajith Pathirana, Director (up to 19 July 2018)	20 March 2015	NED/NID
Mr A K Seneviratne, Director (Ex officio Director) (up to 28 February 2019)	27 May 2015	NED/NID
Mr Anil Rajakaruna, Senior Director (up to 31 December 2018)	2 November 2015	NED/NID
Mr Chandima C Hemachandra, Director (up to 19 July 2018)	2 November 2015	NED/NID
Ms Shehara Jayawardana, Director (up to 12 November 2018)	19 July 2018	NED/NID
Dr D Shanmugasundaram, Director	19 July 2018	NED/NID
Mr U G R Ariyaratne, Director (Ex officio Director)	31 August 2018	NED/ID

NED – Non-Executive Director, NID – Non-Independent Director, ID – Independent Director

The details on current composition of the Board and the profiles of the members are given on page 152 and 131 of the Annual Report.

List of Directors of the Subsidiary of the Bank

Names of the Directors NSB Fund Management Co. Ltd. are as follows:

Mr H N J Chandrasekara – Chairman (w.e.f. 14 March 2019)
Mr S D N Perera – Director
Mr Ajith Pathirana – Director (w.e.f. 14 March 2019)
Mr D S Kudahetty – Director
Ms R E Dangalla – Director
Mr K D A G Wickramasinghe – Director
Mr K D M P Weerasinghe – Director

Board subcommittees

The Board of Directors while assuming the overall responsibility and accountability has also appointed four mandatory Board Subcommittees namely; Board Audit Committee, Board Human Resource and Remuneration Committee, Board Nomination Committee, Board Integrated Risk Management Committee as required by the Banking Act Direction No. 12 of 2007 on "Corporate Governance for Licensed Specialised Banks in Sri Lanka" issued by the CBSL to ensure oversight control over affairs of the Bank.

The Board of Directors has also appointed two other voluntary Board Subcommittees namely; Board Credit Committee and Board Information Technology Strategy Committee to assist the Board in discharging its duties. The Terms of Reference of these Board Subcommittees conform to the recommendations on corporate governance made by regulatory bodies such as CBSL and voluntary codes to the Bank issued by CA Sri Lanka.

The composition of both mandatory and voluntary Board Subcommittees as at 31 December 2018 and the details of the attendance by Directors at meetings are disclosed in pages 152 and 153 and the Reports of these Subcommittee are given on pages 179 to 193.

Directors' meetings

The details of Directors' meetings which comprise Board meetings and Board Subcommittee meetings and the attendance are given in the Corporate Governance Report on pages 152 and 153 of the Annual report.

Directors' interests in contracts

Directors' interests in contracts with the Bank, both direct and indirect are referred to in Note 47 (d) to the Financial Statements on page 340. These interests have been declared at the Board meetings. The Directors do not have any direct or indirect interest in other contracts or proposed contracts with the Bank.

Directors' interest in debentures issued by the Bank

There were no debentures registered in the name of any Director.

Directors' remuneration and other benefits

Details of Directors' emoluments and other benefits in respect of the Bank and the Group for the financial year 2018 are given in Note 47 (d) to the Financial Statements on page 340.

Related party transactions

The Directors have also disclosed the transactions if any, that could be classified as related party transactions in terms of Sri Lanka Accounting Standard (LKAS 24) – "Related Party Disclosures" which is adopted in the preparation of the Financial Statements. Those transactions disclosed by the Directors are given in Note 47 (e) on page 340 to the Financial Statements forming part of the Annual Report of the Board of Directors.

Environmental protection

The Bank and the Group have not, to the best of their knowledge, engaged in activity, which was detrimental to the environment. Specific measures taken to protect the environment are given on pages 120 to 124.

Statutory payments

The Directors, to the best of their knowledge and belief, are satisfied that all statutory payments due to the Government, other regulatory bodies, and in relation to the employees have been made in time.

Events after the reporting date

No circumstances have arisen since the reporting date which would require adjustments to, or disclosure in the accounts, other than those disclosed in Note 50 to the Financial Statements on page 342.

Going concern

The Board of Directors have reviewed and satisfied that the Bank has ample resources to continue its operations in the foreseeable future. Furthermore, the Directors are not aware of any material uncertainties that may cast significant doubt upon the Bank's ability to continue as a going concern, such as restrictions or plan to curtail operations.

Risk management, internal controls and management information systems

The Board of Directors assumes overall responsibility for managing risk. For this purpose, the Board of Directors has instituted and implemented an effective and comprehensive system of internal controls and management information systems in the Bank. Internal control systems have been redesigned to mitigate the risks to which the Bank is exposed, to provide reasonable assurance against material misstatements or loss. There is an ongoing process for identifying evaluating and managing the risks that are faced by the Bank. The specific measures taken by the Bank in mitigating the risk are detailed on pages 194 to 226 in Risk Management Report and Board Integrated Risk Management Report on pages 187 to 189 of this Report.

Appointment of Auditors their remuneration

The Auditor General is the Auditor of National Savings Bank in terms of the provisions of Article 154 of the Constitution of the Democratic Socialist Republic of Sri Lanka.

The expenses incurred in respect of audit fees and other services rendered during the accounting period of 2018 are given in Note 12 to the Financial Statements on page 286.

Regulatory supervision

As a regulatory supervisory body, the Central Bank of Sri Lanka (CBSL) carried out a periodic examination of the records and affairs of the Bank to ascertain compliance with directives issued by the Central Bank of Sri Lanka. It also determines whether required financial indicators are being maintained at the required level so that the interests of the stakeholders, particularly depositors are safeguarded.

Corporate governance

The Directors have placed emphasis on conforming with, the best Corporate Governance Practices and Procedures in managing the Bank. Accordingly, the Directors have declared that:

(a) The Bank has complied with applicable laws and regulations in conducting its business and have not engaged in any activity breaching the relevant laws and regulations.

(b) They have declared all material interest in contracts involving the Bank and refrained from involving any matter which they have a material interest.

(c) The business is a going concern and the Board of Directors have reviewed the Strategic Business Plan and is satisfied that the Bank is having adequate resources to accelerate the future momentum of NSB in foreseeable future. Thus, the Financial Statements of the Bank and its Subsidiary are prepared based on the going concern assumption.

(d) The Bank has disclosed in the Financial Statements on Related Party Transactions.

(e) The Bank has conducted a review on internal controls which covers financial, operational and compliance controls, risk management and have obtained a reasonable assurance of their effectiveness and adherence.

Focus on new regulations

The Bank has conducted the impact assessment of SLFRS 16 on "Leases" which will be effective from 1 January 2019 and developed required models to assess the impact under the new standard.

Sustainability

When formulating its business strategies, the Bank has considered the sustainability aspects, the details of which are disclosed in pages 125 to 128 under GRI Index.

Human resources

The Bank continued to develop and maintain dedicated and highly-motivated employees who are committed to create sustainable value through high quality service. Significant investments have been made in the development of quality of Human Capital of the Bank. The policies and procedures adopted by the Bank to upgrade Human Capital is described in this Annual Report 2018 on page 93.

Outstanding litigation

In the opinion of the Directors and the Bank's lawyers, outstanding litigation against the Bank disclosed in Note 49 to the Financial Statements on page 341 will not have a material impact on the financial position of the Bank or its future operations.

Acknowledgement of the contents of the report

The Board of Directors hereby acknowledge the contents of this Annual Report.

By Order of the Board,

Jayaraja Chandrasekera
Chairman

M A P Muhandiram
Secretary to the Board

14 March 2019
Colombo

Statement of Directors' Responsibility for Financial Reporting

The responsibility of the Directors in relation to the Financial Statements of the National Savings Bank (the Bank) and the Consolidated Financial Statements of the Bank and its Subsidiary (the Group) is set out in this Statement.

Financial Statements

The Directors of the Bank are responsible for ensuring that the Bank and the Group keep proper books of accounts of all the transactions and prepare Financial Statements in accordance with Generally Accepted Accounting Principles, Sri Lanka Accounting Standards and Sri Lanka Financial Reporting Standards that give a true and fair view of the financial position of the Bank and the Group at the end of each financial year in compliance with the relevant statutory requirements. The Financial Statements comprise, the Statement of Financial Position as at 31 December 2018, the Income Statement and the Statement of Comprehensive Income, Statement of Changes in Equity and Statement of Cash Flows for the year ended 2018 and Significant Accounting Policies and Notes thereto.

Accordingly, the Board of Directors confirm that, the Financial Statements of the Bank and its Subsidiary give a true and fair view of the:

1. Financial Position of the Bank and its Subsidiary as at 31 December 2018; and
2. Financial performance of the Bank and its Subsidiary for the financial year then ended.

In preparing these Financial Statements, the Directors are required to ensure that:

1. The accounting policies adopted to prepare the Financial Statements which are depicted in pages 258 to 276 were appropriate according to the existing financial reporting framework. These policies were consistently applied and material departures if any have been adequately disclosed.
2. Reasonable and prudent judgements have been made where necessary to ensure the proper reflection of the form and substance of transaction when preparing the Financial Statements.
3. The Financial Statements of the Bank and the Group are prepared in accordance with the Sri Lanka Accounting Standards (SLFRSs/LKASs).

As per the provisions of the Finance Act No. 38 of 1971, the Banking Act No. 30 of 1988 and Section 7 (i) of NSB Act No. 30 of 1971, the Board of Directors is required to control and administer the affairs and the business of the Bank.

The Board of Directors ensures that the Financial Statements comply with the prescribed format issued by the Central Bank for Licensed Banks.

The Board of Directors are also responsible for ensuring that proper accounting records which correctly record and explain the Bank's financial position, with reasonable accuracy at any point of time is determined by the Bank, enabling preparation of the Financial Statements.

The Board of Directors accepts the responsibility for the integrity and objectivity of the Financial Statements presented in this Annual Report (Financial Statements are exhibited on pages 248 to 257). The Financial Statements for the year 2018 prepared and presented in this Annual Report are consistent with the underlying books of accounts and are in conformity with the requirements of Sri Lanka Accounting Standards, Sri Lanka Accounting and Auditing Standards Act No. 15 of 1995 and Banking Act No. 30 of 1988 and amendments thereto.

Internal controls

The Board of Directors has been responsible for taking reasonable measures and care to safeguard the assets of the Bank and the Group, detect frauds and other irregularities and has also instituted an effective and comprehensive system of internal controls and an effective system of monitoring its effectiveness which includes internal audit and applied and practiced within predetermined procedures and limits. The Directors ensure that the Financial Statements are reviewed by them directly at their regular meetings and also through the Board Audit Committee. The Directors' Statement on Internal Control Over Financial Reporting is given on page 238 of this Annual Report and Auditor General's Assurance Report on the Bank's Internal Control is given on page 240.

Audit report

The Auditor General has been made available with all records of the Bank including the Financial Statements by the Board of Directors and provided every opportunity to undertake the inspections they considered appropriate all of which the Auditor General's Department has examined and have expressed the Auditor General's opinion which appears as reported by him on page 245 of this Annual Report.

Compliance report

The Directors confirm that to the best of their knowledge and belief that all taxes, duties and levies payable by the Bank and the Group and all contributions and taxes payable on behalf of and in respect of employees of the Bank and the Group, and all other known statutory dues to the Government and the other relevant regulatory and statutory authorities which were due and payable by the Bank and the Group as at the date of Statement of Financial Position have been paid or where relevant provided for. Further, the Directors have confirmed that after considering the financial position, operating conditions, regulatory and other factors required to be addressed in the "Code of Best Practice on Corporate Governance" issued by CA Sri Lanka.

The Bank and the Group have adequate resources to continue in operation for the foreseeable future and to justify the application of the going concern basis in preparing these Financial Statements and the Board has taken all necessary measures to comply with the directives issued by the Central Bank of Sri Lanka.

By Order of the Board,

M A P Muhandiram
Secretary to the Board

14 March 2019
Colombo

Directors' Statement on Internal Control over Financial Reporting

Responsibility

This report has been issued in line with the Banking Act Direction No. 12 of 2007, Section 3 (8) (ii) (b), and prepared based on principles D.1.5 of Code of Best Practice on Corporate Governance 2017 issued by The Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka) (Code) the Board of Directors presents this report on internal control.

The Board of Directors (The Board) is responsible for ensuring that an adequate and effective system of internal control is established and maintained at the National Savings Bank. However, such a system is designed to manage the Bank's significant risk areas within acceptable risk parameters, rather than eliminating the risk of failure to achieve business objectives of the Bank. Accordingly, the system of internal controls can only provide reasonable but not absolute assurance against material misstatement of management and financial information and records or against financial losses or frauds.

The Board has established an ongoing process for identifying, evaluating and managing the significant risks faced by the Bank and this process includes enhancing the system of internal controls as and when there are changes to business environment or regulatory requirements and other guidelines. The process is regularly reviewed by the Board and confirmed the compliance with the Guidance for Directors of the Bank's on the Directors' Statement on Internal Controls issued by CA Sri Lanka. The Board has assessed the internal control system taking into principles for the assessment of internal control system as given in that guidance.

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

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

Key features of the process adopted in applying and reviewing the design and effectiveness of the internal control system on financial reporting

The Board has also put in place the system of reviewing the design and the effectiveness of system of internal control periodically. The key processes, among other things include the following:

- The Board Subcommittees have been established with defined scopes and functions to assist the Board in ensuring the effectiveness of the Bank's operations and that the Bank's operations are in accordance with the corporate objectives, strategies, and policies and business directions that have been approved.
- The Board Audit Committee (BAC) reviews periodically the internal control issues identified by the Internal Audit Division of the Bank, the External Auditors, Regulatory Authorities and corrective actions taken to rectify such deficiencies. The Auditor General carries out the external audit of the Bank. The Superintendent of the Government Audit is generally invited to BAC meetings.
- The BAC reviews the internal audit function with particular emphasis on the scope of audits and quality of the same. The activities attended to by the BAC during the year 2018 are set out in the Board Audit Committee Report appearing on page 179 of this Annual Report. The Internal Audit Division of the Bank carries out audit of branches, divisions and other units as per the Annual Audit Plan. The frequency of audit is determined by the level of risk assessed. The Audit Plan is approved by the BAC for implementation. The Internal Audit Division carries out audit checks to ensure compliance with policies and procedures and the effectiveness of the internal control systems and reports its findings in respect of any non-compliance. Audits are carried out to provide an independent and objective report on operational and management activities. The findings of the audits are submitted to the BAC for review at their periodic meetings. The activities of the BAC, along with minutes of the Committee meetings are submitted for information of the Board on a periodic basis.
- The Board Integrated Risk Management Committee (BIRMC) has been established by the Board to assist the Board to oversee the overall management of principal areas of risk of the Bank. The Board has also established an independent Compliance Unit which ensures that Bank's activities are conducted in accordance with applicable laws, regulations and regulatory directives and any issues of non-compliance are reported to BIRMC periodically. The report on the risk assessment is submitted by the BIRMC to the Board periodically.

- Management level committees have also been functioning with appropriate empowerment to ensure effective management and supervision of Bank's core areas in the day-to-day business operations. The assessment covered only the process applied by the Bank and did not include the processes carried out by its subsidiary.

The Bank adopted the new Sri Lanka Accounting Standards Comprising LKAS and SLFRS in 2012. Since adoption of such Sri Lanka Accounting Standards, continue monitoring and progressive enhancement on processes to comply with new requirements of recognition, measurement, classification, and disclosure are being made.

The Board also has taken into consideration the requirements of the Sri Lanka Accounting Standard – SLFRS 9 on "Financial Instruments" that is effective from 1 January 2018, as it had a significant impact on the calculation of impairment of financial instruments on an "expected credit loss model" compared to the "incurred credit loss model".

The Bank carried out a gap analysis with the assistance of Messrs Ernst & Young to identify areas expected to have a potentially higher impact on amounts already reported in financial statements as at 31 December 2017 consequent to adoption of SLFRS 9. Subsequent to that and as per the Implementation Plan of the Working Committee formed, Bank developed statistical models to compute the expected credit loss as require by SLFRS 9. The Bank has restated its financial statements to comply with the SLFRS 9.

The Board has taken into consideration the requirement of the SLFRS – 16 "Leases" which is effective from 1 January 2019 and necessary steps are being taken to assess its impact to financial statements.

Confirmation

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

Review of the Statement by the External Auditors

The External Auditors, the Auditor General has reviewed the above Directors' Statement on Internal Control Over Financial Reporting for the year ended 31 December 2018 and report to the Board of Directors that nothing has come to their attention that causes them to believe that the statement is inconsistent with their understanding of the process adopted by the Board in the review of the design and effectiveness of the internal control system over financial reporting of the Bank. Their Report on the Statement of Internal Control over Financial Reporting is given on page 240 of this Annual Report.

By Order of the Board,

Jayaraja Chandrasekera
Chairman

Dr D Shanmugasundaram
Chairman – Board Audit Committee/Director

Anil Rajakaruna
Senior Director

14 March 2019
Colombo

Independent Assurance Report on Internal Control

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தேசிய கணக்காய்வு அலுவலகம்
NATIONAL AUDIT OFFICE

මගේ අංකය / எனது இல. / My No. } BAF/A/NSB/2018/14 ඔබේ අංකය / உமது இல. / Your No. } දිනය / திகதி / Date } 02 May 2019

The Chairman
National Savings Bank

Assurance Report of the Auditor General to the Board of Directors on the Directors' Statement on Internal Control of National Savings Bank.

Introduction

This report is to provide assurance on the Directors' Statement on Internal Control ("Statement") of National Savings Bank included in the Annual Report for the year ended 31 December 2018.

Management's responsibility

Management is responsible for the preparation and presentation of the Statement in accordance with the "Guidance for Directors of Bank on the Directors' Statement on Internal Control" issued in compliance with the Section 3 (8) (ii) (b) of the Banking Act Direction No. 12 of 2007, by The Institute of Chartered Accountants of Sri Lanka.

My responsibilities and compliance with SLSAE 3050

My responsibility is to issue a report to the Board of Directors on the Statement based on the work performed. I conducted my engagement in accordance with Sri Lanka Standard on Assurance Engagements SLSAE 3050 – Assurance Report for Banks on Directors' Statement on Internal Control issued by The Institute of Chartered Accountants of Sri Lanka.

Summary of work performed

My engagement has been conducted to assess whether the Statement is both supported by the documentation prepared by or for Directors and appropriately reflects the process the Directors have adopted in reviewing the system of internal control for the Bank.

The procedures performed are limited primarily to inquiries of Bank personnel and the existence of documentation on a sample basis that supports the process adopted by the Board of Directors.

SLSAE 3050 does not require me to consider whether the Statement covers all risks and controls, or to form an opinion on the effectiveness of the Bank's risk and control procedures. SLSAE 3050 also does not require me to consider whether the processes described to deal with material internal control aspects of any significant problems disclosed in the Annual Report will, in fact, remedy the problems.

My conclusion

Based on the procedures performed, nothing has come to my attention that causes me to believe that the Statement included in the Annual Report is inconsistent with my understanding of the process the Board of Directors has adopted in the review of the design and effectiveness of internal control over financial reporting of the Bank.

W P C Wickramaratne
Auditor General

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GRI 102-56

Independent Assurance Report

KPMG
(Chartered Accountants)
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Independent Assurance Report to National Savings Bank

We have been engaged by the Directors of National Savings Bank ("Bank") to provide reasonable assurance and limited assurance in respect of the Sustainability Indicators as identified below for the year ended 31 December 2018. The Sustainability Indicators are included in National Savings Bank's Integrated Annual Report for the year ended 31 December 2018 (the "Report").

The reasonable assurance sustainability indicators covered by our reasonable assurance engagement are:

Reasonable assurance sustainability indicators	Integrated Annual Report page
Financial highlights	8

The limited assurance sustainability indicators covered by our limited assurance engagement are:

Limited assurance – sustainability indicators	Integrated Annual Report page
Non-financial highlights	9
Information provided on following capitals	
Financial capital	66 – 82
Manufactured capital	83 – 87
Intellectual capital	88 – 92
Human capital	93 – 105
Social and relationship capital	106 – 119
Natural capital	120 – 124

Our conclusions

Our conclusion has been formed on the basis of, and is subject to, the matters outlined in this Report. We believe that the evidence we have obtained is sufficient and appropriate to provide a basis for our conclusions.

Reasonable assurance-sustainability indicators

In our opinion, the Reasonable Assurance-Sustainability Indicators, as defined above, for the year ended 31 December 2018 are, in all material respects, prepared and presented in accordance with the Consolidated Set of Global Reporting Initiative Sustainability Reporting Standards Guidelines.

Limited assurance-sustainability indicators

Based on the limited assurance procedures performed and evidence obtained, as described below, nothing has come to our attention that causes us to believe that the Limited Assurance-Sustainability Indicators, as defined above, for the year ended 31 December 2018, have not in all material respects, been prepared and presented in accordance with the Consolidated Set of Global Reporting Initiative Sustainability Reporting Standards Guidelines.

Management's responsibility

Management is responsible for the preparation and presentation of the Reasonable Assurance Sustainability Indicators and the Limited Assurance Sustainability Indicators in accordance with the Consolidated Set of Global Reporting Initiative Sustainability Reporting Standards Guidelines.

These responsibilities includes establishing such internal controls as Management determines are necessary to enable the preparation of the Reasonable Assurance Sustainability Indicators and the Limited Assurance Sustainability Indicators that are free from material misstatement whether due to fraud or error.

Management is responsible for preventing and detecting fraud and for identifying and ensuring that the Bank complies with laws and regulations applicable to its activities.

Management is also responsible for ensuring that staff involved with the preparation and presentation of the description and Report are properly trained, information systems are properly updated and that any changes in reporting encompass all significant business units.

Our responsibility

Our responsibility is to express a reasonable assurance conclusion on the Bank's preparation and presentation of the Reasonable Assurance Sustainability Indicators and a limited assurance conclusion on the preparation and presentation of the Limited Assurance Sustainability Indicators included in the Report, as defined above.

Independent Assurance Report

KPMG

We conducted our assurance engagement in accordance with Sri Lanka Standard on Assurance Engagements SLSAE 3000: Assurance Engagements other than Audits or Reviews of Historical Financial Information (SLSAE 3000) issued by The Institute of Chartered Accountants of Sri Lanka.

We have complied with the independence and other ethical requirements of the Code of Ethics issued by the Institute of Chartered Accountants of Sri Lanka.

SLSAE 3000 requires that we plan and perform the engagement to obtain reasonable assurance about whether the Reasonable Assurance Sustainability Indicators are free from material misstatement and limited assurance about whether the Limited Assurance Sustainability Indicators are free from material misstatement.

Reasonable Assurance Over Reasonable Assurance Sustainability Indicators →

The procedures selected in our reasonable assurance engagement depend on our judgement, including the assessment of the risks of material misstatement of the Reasonable Assurance Sustainability Indicators whether due to fraud or error.

In making those risk assessments, we have considered internal control relevant to the preparation and presentation of the Reasonable Assurance Sustainability Indicators in order to design assurance procedures that are appropriate in the circumstances, but not for the purposes of expressing a conclusion as to the effectiveness of the Bank's internal control over the preparation and presentation of the Report.

Our engagement also included assessing the appropriateness of the Reasonable Assurance Sustainability Indicators, the suitability of the criteria, being the Consolidated Set of Global Reporting Initiative Sustainability Reporting Standards Guidelines, used by the Bank in preparing and presenting the Reasonable Assurance Sustainability Indicators within the Report, obtaining an understanding of the compilation of the financial and non-financial information to the sources from which it was obtained, evaluating the reasonableness of estimates made by the Bank, and recomputation of the calculations of the Reasonable Assurance Sustainability Indicators.

Limited Assurance on the Assured Sustainability Indicators →

Our limited assurance engagement on the Limited Assurance Sustainability Indicators consisted of making enquiries, primarily of persons responsible for the preparation of the Limited Assurance Sustainability Indicators, and applying analytical and other procedures, as appropriate. These procedures included:

- interviews with Senior Management and relevant staff at corporate and selected site level concerning sustainability strategy and policies for material issues, and the implementation of these across the business;
- enquiries of management to gain an understanding of the Bank's processes for determining material issues for the Bank's key stakeholder groups;
- enquiries of relevant staff at corporate and selected site level responsible for the preparation of the Limited Assurance Sustainability Indicators;
- enquiries about the design and implementation of the systems and methods used to collect and report the Limited Assurance Sustainability Indicators, including the aggregation of the reported information;
- comparing the Limited Assurance Sustainability Indicators to relevant underlying sources on a sample basis to determine whether all the relevant information has been appropriately included in the Report;
- reading the Limited Assurance Sustainability Indicators presented in the Report to determine whether they are in line with our overall knowledge of, and experience with, the sustainability performance of the Bank;
- reading the remainder of the Report to determine whether there are any material misstatements of fact or material inconsistencies based on our understanding obtained as part of our assurance engagement.

The procedures performed in a limited assurance engagement vary in nature and timing from, and are less in extent than for, a reasonable assurance engagement, and consequently the level of assurance obtained in a limited assurance engagement is substantially lower than the assurance that would have been obtained had a reasonable assurance engagement been performed. Accordingly, we do not express a reasonable assurance conclusion on the Limited Assurance Sustainability Indicators.

Purpose of our report

In accordance with the terms of our engagement, this assurance report has been prepared for the Bank for the purpose of assisting the Directors in determining whether the Bank's Reasonable and Limited Assurance Sustainability Indicators are prepared and presented in accordance with the Consolidated Set of Global Reporting Initiative Sustainability Reporting Standards Guidelines and for no other purpose or in any other context.

Restriction of use of our report

Our report should not be regarded as suitable to be used or relied on by any party wishing to acquire rights against us other than the Bank, for any purpose or in any other context. Any party other than the Bank who obtains access to our report or a copy thereof and chooses to rely on our report (or any part thereof) will do so at its own risk. To the fullest extent permitted by law, we accept or assume no responsibility and deny any liability to any party other than the Bank for our work, for this independent assurance report, or for the conclusions we have reached.

KPMG

Chartered Accountants

Colombo

27 March 2019

General Manager/CEO's and Deputy General Manager's (Finance and Planning) Statement of Responsibility

Compliance

The Financial Statements of the National Savings Bank (the Bank) and the Consolidated Financial Statements of the Bank and its Subsidiary (the Group) as at 31 December 2018 are prepared and presented in compliance with the following:

- National Savings Bank Act No. 30 of 1971 and amendments thereto.
- Finance Act No. 38 of 1971.
- Sri Lanka Accounting and Auditing Standards Act No. 15 of 1995.
- Banking Act No. 30 of 1988 and amendments thereto and Directions, Determinations and Guidelines issued by the Central Bank of Sri Lanka (CBSL) there under relating to Financial Statements, formats and disclosure of information.
- Sri Lanka Financial Reporting Standards/Sri Lanka Accounting Standards (SLFRSs/LKASs) issued by The Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka).
- Code of Best Practice on Corporate Governance 2017 issued by The Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka).
- The Banking Act Direction No. 12 of 2007 on Corporate Governance issued by the CBSL.

The formats used in the preparation of the Financial Statements and disclosures made, comply with the specified formats prescribed by the Central Bank of Sri Lanka which are also in compliance with the disclosure requirements of the Sri Lanka Accounting Standard 1 (LKAS 1) – "Presentation of Financial Statements". The Bank and the Group presents the financial results to its users on a quarterly basis.

The Accounting Policies used in the preparation of the Financial Statements are appropriate and are consistently applied by the Bank and the Group. The Bank and the Group restated the comparative information for 2017 with regard to the financial instrument with the scope of SLFRS 9. The Significant Accounting Policies and estimates that involved a high degree of judgement and complexity were discussed with the Bank's External Auditors and the Board Audit Committee (BAC). Comparative information has been restated wherever necessary to comply with the current presentation and material departures, if any, have been disclosed and explained.

The Bank applied the Sri Lanka Accounting Standard – SLFRS 9 on "Financial Instruments", which replaced the Sri Lanka Accounting Standard – LKAS 39 on Financial Instruments: "Recognition and Measurement" which was effective until 31 December 2017. The Bank had a significant impact on calculation of impairment of financial instruments on an "expected loss model" on adoption of the Sri Lanka Accounting Standard – SLFRS 9 on "Financial Instruments" compared to "incurred credit loss model" applied until 31 December 2017 under the Sri Lanka Accounting Standard – LKAS 39 on Financial Instruments: Recognition and Measurement". The Bank has restated the Financial Statements of prior period as permitted by the Sri Lanka Accounting Standard – SLFRS 9 on "Financial Instruments". Accordingly, comparative information has been restated and disclosed under Note 52 of the Notes to the Financial Statements.

We confirm that to the best of our knowledge, the Financial Statements, Significant Accounting Policies and other financial information included in this Annual Report, fairly present in all material aspects of the assets, liabilities, results of the operations and the cash flows of the Bank and the Group during the year under review and given a true and fair view of the Financial Statements. We also confirm that the Bank and the Group has adequate resources to continue in operation and have applied the going concern basis in preparing these Financial Statements.

Responsibility of internal control and procedures

We are responsible for establishing, implementing and maintaining internal controls and procedures of the Bank and its Subsidiary. We ensure that effective internal controls and procedures are in place ensuring material information relating to the Bank and the Group are made known to us for safeguarding assets, preventing and detecting fraud and/or error as well as other irregularities, which are reviewed, evaluated and updated on an ongoing basis. We are satisfied that there were no significant deficiencies and weaknesses in the design or operation of the internal controls and procedures, to the best of our knowledge. We confirm, based on our evaluations, that there were no significant deficiencies and material weaknesses in the design or operation of

General Manager/CEO's and Deputy General Manager's (Finance and Planning) Statement of Responsibility

internal controls and any fraud that involved Management or other employees. The Bank's Internal Auditors also conduct periodic reviews to ensure that the established internal controls over financial reporting and procedures are consistently followed. However, there are inherent limitations that should be recognised in weighing the assurance provided by any system of internal control and accounting.

Directors' Statement on Internal Control over Financial Reporting is provided on page 238 of this Annual Report. The Auditor General have audited the effectiveness of the internal controls over financial reporting adapted by the Bank and have given an unqualified opinion and provided on page 240 of this Annual Report.

External audit

The Financial Statements of the Bank and its Subsidiary were audited by the Auditor General. The Auditor General's Report on the Bank's Consolidated Financial Statements is given on page 245 of this Annual Report. The Board Audit Committee, *inter alia*, reviewed all internal audit and inspection programmes, the efficiency of internal control systems and procedures and also reviewed the Significant Accounting Policies and their adherence to statutory and regulatory requirements, the details of which are given in the Board Audit Committee Report on pages 179 to 182 of this Annual Report. To ensure complete independence, the Auditor General and the Internal Auditors have full and free access to the members of the Board Audit Committee to discuss any matter of substance.

Confirmation

We confirm that to the best of our knowledge –

- The Bank and the Group have complied with all applicable laws and regulations and prudential requirement.
- There are no materials non-compliances and
- There are no material litigations that are pending against the Bank and the Group other than those disclosed in Note 49 on page 341 of the Financial Statements.
- All taxes, duties, levies and all statutory payments payable by the Bank and the Group and all contributions, levies and taxes payable on behalf of and in respect of the employees of the Bank and the Group as at 31 December 2018 have been paid, or where relevant, provided for.

Dammika Perera
General Manager/CEO

Kithsiri Wijeyaratne
Deputy General Manager
(Finance and Planning)

14 March 2019
Colombo

Auditor General's Report

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தேசிய கணக்காய்வு அலுவலகம்
NATIONAL AUDIT OFFICE

My No. BAF/A/NSB/FA/2018/13 | Your No. | Date 27 March 2019

Chairman

National Savings Bank

Report of the Auditor General on the Financial Statements and Other Legal and Regulatory Requirements of the National Savings Bank and its subsidiary for the year ended 31 December 2018 in terms of Section 12 of the National Audit Act, No. 19 of 2018.

1. Financial Statements

1.1 Opinion

The audit of the Financial Statements of the National Savings Bank ("Bank") and the Consolidated Financial Statements of the Bank and its Subsidiary ("Group") for the year ended 31 December 2018 comprising the Statements of Financial Position as at 31 December 2018 and the Statements of Comprehensive Income, Statement of Changes in Equity and Cash Flow Statement for the year then ended, and Notes to the Financial Statements, including a summary of significant accounting policies, was carried out under my direction in pursuance of provisions in Article 154 (1) of the Constitution of the Democratic Socialist Republic of Sri Lanka read in conjunction with provisions of the National Audit Act No. 19 of 2018. My report to Parliament in pursuance of provisions in Article 154 (6) of the Constitution will be tabled in due course.

In my 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 2018, and of their financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

1.2 Basis for opinion

I conducted my audit in accordance with Sri Lanka Auditing Standards (SLAuSs). My responsibilities, under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of my Report. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

1.3 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 determine 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.

As per Section 16 (1) of the National Audit Act No. 19 of 2018, the Group is required to maintain proper books and records of all its income, expenditure, assets and liabilities, to enable annual and periodic financial statements to be prepared of the Group.

1.4 Auditor's Responsibilities for the Audit of the Financial Statements

My objective is 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 Auditor's Report that includes my opinion.

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Auditor General's Report

ජාතික විගණන කාර්යාලය
தேசிய கணக்காய்வு அலுவலகம்
NATIONAL AUDIT OFFICE
NAOSL

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Sri Lanka Auditing Standards 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 Sri Lanka Auditing Standards, I exercise professional judgement and maintain professional scepticism throughout the audit. I 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 my 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 Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Management.
- Conclude on the appropriateness of the 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 I conclude that a material uncertainty exists, I am required to draw attention in my Auditor's Report to the related disclosures in the Financial Statements or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my Auditor's 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.

I communicate with those charged with governance regarding, among other matters, significant audit findings, including any significant deficiencies in internal control that I identify during my audit.

2. Report on Other Legal and Regulatory Requirements

National Audit Act, No. 19 of 2018 includes specific provisions for following requirements.

- I have obtained all the information and explanation that required for the audit and as far as appears from my examination, proper accounting records have been kept by the Bank as per the requirement of Section 12 (a) of the National Audit Act, No. 19 of 2018.
- The Financial Statements presented is consistent with the preceding year as per the requirement of Section 6 (1) (d) (iii) of the National Audit Act, No. 19 of 2018.
- The financial statements presented includes all the recommendations made by me in the previous year as per the requirement of section 6 (1) (d) (iv) of the National Audit Act, No. 19 of 2018.

Based on the procedures performed and evidence obtained were limited to matters that are material, nothing has come to my attention:

- to state that any member of the governing body of the Bank has any direct or indirect interest in any contract entered into by the Bank which are out of the normal cause of business as per the requirement of Section 12 (d) of the National Audit Act, No. 19 of 2018;
- to state that the Bank has not complied with any applicable written law, general and special directions issued by the governing body of the Bank as per the requirement of Section 12 (f) of the National Audit Act, No. 19 of 2018;
- to state that the Bank has not performed according to its powers, functions and duties as per the requirement of Section 12 (g) of the National Audit Act, No. 19 of 2018;
- to state that the resources of the Bank had not been procured and utilised economically, efficiently and effectively within the time frames and in compliance with the applicable laws as per the requirement of Section 12 (h) of the National Audit Act, No. 19 of 2018.

H M Gamini Wijesinghe
Auditor General

Content of Financial Statements

Income Statement

For the year ended 31 December	Note	Bank 2018 Rs. '000	Bank 2017 Restated Rs. '000	Bank Change %	Group 2018 Rs. '000	Group 2017 Restated Rs. '000	Group Change %
Gross income	3	**111,902,078**	107,995,784	4	**112,760,454**	108,234,622	4
Interest income		**110,506,931**	103,578,838	7	**111,718,948**	104,424,417	7
Less: Interest expenses		**85,622,275**	78,444,825	9	**86,460,269**	78,987,596	9
Net interest income	4	**24,884,656**	25,134,013	(1)	**25,258,679**	25,436,821	(1)
Fee and commission income		**1,005,262**	782,776	28	**1,008,482**	785,077	28
Less: Fee and commission expenses		**141,196**	109,082	29	**144,685**	113,037	28
Net fee and commission income	5	**864,066**	673,694	28	**863,797**	672,040	29
Net gain/(loss) from trading	6	**(707,433)**	1,206,408	(159)	**(1,062,421)**	1,520,740	(170)
Net fair value gains/(losses) from financial instruments at fair value through profit or loss	7	**–**	–	–	**–**	–	–
Net gains/(losses) from derecognition of financial assets	8	**6,906**	707,491	(99)	**6,906**	707,491	(99)
Net other operating income	9	**1,090,412**	1,720,272	(37)	**1,088,539**	796,897	37
Total operating income		**26,138,607**	29,441,877	(11)	**26,155,500**	29,133,988	(10)
Less: Impairment charges	10	**871,049**	765,847	14	**870,994**	765,858	14
Net operating income		**25,267,558**	28,676,030	(12)	**25,284,506**	28,368,130	(11)
Less: Expenses							
Personnel expenses	11	**9,262,705**	6,886,505	35	**9,302,548**	6,918,813	34
Depreciation and amortisation expenses		**638,795**	423,547	51	**639,779**	424,352	51
Other expenses	12	**4,194,979**	3,737,364	12	**4,160,782**	3,682,765	13
Operating profit before value added tax (VAT), nation building tax (NBT) and debt repayment levy (DRL) on financial services		**11,171,079**	17,628,615	(37)	**11,181,397**	17,342,200	(36)
Less: VAT on financial services		**2,577,657**	3,082,619	(16)	**2,584,220**	3,168,299	(18)
NBT on financial services		**343,688**	411,016	(16)	**344,563**	422,440	(18)
DRL on financial services		**308,371**	–	100	**308,371**	–	100
Operating profit after VAT, NBT and DRL on financial services		**7,941,364**	14,134,980	(44)	**7,944,243**	13,751,461	(42)
Share of profits of associates and joint ventures		**–**	–	–	**–**	–	–
Profit before income tax		**7,941,364**	14,134,980	(44)	**7,944,243**	13,751,461	(42)
Less: Income tax expenses	13	**3,441,213**	4,419,019	(22)	**3,444,056**	4,595,065	(25)
Profit for the year		**4,500,151**	9,715,961	(54)	**4,500,187**	9,156,396	(51)
Profit attributable to:							
Equity holders of the Bank		**4,500,151**	9,715,961	(54)	**4,500,187**	9,156,396	(51)
Non-controlling interests		**–**	–	–	**–**	–	–
Profit for the year		**4,500,151**	9,715,961	(54)	**4,500,187**	9,156,396	(51)
Earnings per share on profit							
Basic earnings per ordinary share (Rs.)	14	**6.72**	15.67	(57)	**6.72**	14.77	(55)
Diluted earnings per ordinary share (Rs.)		**6.72**	15.67	(57)	**6.72**	14.77	(55)
Profit for the year		**4,500,151**	9,715,961	(54)	**4,500,187**	9,156,396	(51)

Statement of Comprehensive Income

For the year ended 31 December	Note	Bank 2018 Rs. '000	Bank 2017 Restated Rs. '000	Bank Change %	Group 2018 Rs. '000	Group 2017 Restated Rs. '000	Group Change %
Profit for the year		**4,500,151**	9,715,961	(54)	**4,500,187**	9,156,396	(51)
Items that will be reclassified to income statement							
Exchange differences on translation of foreign operations		–	–	–	–	–	–
Net gains/(losses) on cash flow hedges		**(291,924)**	290,074	(201)	**(291,924)**	290,074	(201)
Net gains/(losses) on investments in debt instruments measured at fair value through other comprehensive income		–	–	–	–	–	–
Share of profits of associates and joint ventures		–	–	–	–	–	–
Debt instruments at fair value through other comprehensive income		**(127,741)**	693,559	(118)	**(149,144)**	858,802	(117)
Less: Fair value gains/(losses) transferred to income statement on disposal of debt instrument at fair value through other comprehensive income		**1,370**	(690,388)	99	**1,370**	(690,388)	99
Less: Tax expense relating to items that will be reclassified to income statement		–	–	–	–	–	–
Total items that will be reclassified to income statement		**(418,295)**	293,245	(243)	**(439,698)**	458,488	(196)
Items that will not be reclassified to income statement							
Change in fair value on investments in equity instruments designated at fair value through other comprehensive income		**(690,435)**	(36,752)	1,779	**(690,435)**	(36,752)	1,779
Change in fair value attributable to change in the Bank's own credit risk on financial liabilities designated at fair value through profit or loss		–	–	–	–	–	–
Remeasurement of post-employment benefit obligations		**(210,861)**	(2,072,425)	(90)	**(211,258)**	(2,072,155)	(90)
Changes in revaluation surplus		–	4,508,480	(100)	–	4,508,480	(100)
Share of profits of associates and joint ventures		–	–	–	–	–	–
Less: Tax expense relating to items that will not be reclassified to income statement		–	–	–	–	–	–
Total items that will not be reclassified to income statement		**(901,296)**	2,399,303	(138)	**(901,694)**	2,399,573	(138)
Other comprehensive income for the year, net of taxes		**(1,319,591)**	2,692,547	(149)	**(1,341,392)**	2,858,060	(147)
Total comprehensive income for the year		**3,180,560**	12,408,508	(74)	**3,158,795**	12,014,456	(74)
Attributable to:							
Equity holders of the Bank		**3,180,560**	12,408,508	(74)	**3,158,795**	12,014,456	(74)
Non-controlling interests		–	–	–	–	–	–
Total comprehensive income for the year		**3,180,560**	12,408,508	(74)	**3,158,795**	12,014,456	(74)

The Notes to the Financial Statements disclosed on pages 258 to 380 are integral parts of these Financial Statements.

Statement of Financial Position

As at 31 December	Note	Bank 2018 Rs. '000	Bank 2017 Restated Rs. '000	Bank Change %	Group 2018 Rs. '000	Group 2017 Restated Rs. '000	Group Change %
Assets							
Cash and cash equivalents	16	**3,434,524**	3,849,530	(11)	**3,436,929**	3,853,989	(11)
Balances with central banks	17	–	–	–	**177**	94	89
Placements with banks	18	**17,588,445**	23,437,274	(25)	**17,588,445**	23,437,274	(25)
Derivative financial instruments	19	**4,740,106**	1,360,714	248	**4,740,106**	1,360,714	248
Financial assets recognised through profit or loss	20						
– measured at fair value		**16,680,382**	6,472,314	158	**26,867,533**	9,389,950	186
– designated at fair value		–	–	–	–	–	–
Financial assets at amortised cost							
– loans and advances	21	**423,532,145**	375,703,730	13	**423,557,119**	374,416,626	13
– debt and other instruments	22	**518,947,969**	555,468,618	(7)	**522,973,159**	559,319,752	(6)
Financial assets measured at fair value through other comprehensive income	23	**6,184,430**	5,693,829	9	**7,788,560**	7,513,932	4
Investments in subsidiaries	24	**1,700,000**	900,000	89	–	–	–
Investments in associates and joint ventures	25	–	–	–	–	–	–
Property, plant and equipment	26	**13,465,755**	12,395,684	9	**13,468,776**	12,399,334	9
Investment properties	27	–	–	–	–	–	–
Goodwill and intangible assets	28	–	–	–	–	–	–
Deferred tax assets	29	–	–	–	**73**	–	100
Other assets	30	**31,209,216**	25,695,689	21	**31,532,684**	25,976,944	21
Total assets		**1,037,482,973**	1,010,977,382	3	**1,051,953,560**	1,017,668,610	3
Liabilities							
Due to banks	31	**77,119,146**	48,596,591	59	**83,615,264**	49,352,574	69
Derivative financial instruments	32	**1,533**	956,937	(100)	**1,533**	956,937	(100)
Financial liabilities recognised through profit or loss	33	–	–	–	–	–	–
Financial liabilities at amortised cost	34						
– due to depositors		**839,574,411**	737,212,640	14	**839,574,411**	737,212,640	14
– due to debt securities holders		–	–		–	–	–
– due to other borrowers		**14,804,802**	12,837,008	15	**21,750,178**	17,545,212	24
Debt securities issued	35	**52,389,133**	162,709,027	(68)	**52,389,133**	162,709,027	(68)
Retirement benefit obligations	36	**3,830,795**	3,711,431	3	**3,832,777**	3,712,665	3
Current tax liabilities	37	–	–	–	–	137,344	(100)
Deferred tax liabilities	29	**582,463**	507,063	15	**582,463**	507,138	15
Other provisions	38	–	–	–	–	–	–
Other liabilities	39	**5,447,277**	5,350,244	2	**5,452,317**	5,394,795	1
Due to subsidiaries	40	**750**	750	–	–	–	–
Total liabilities		**993,750,308**	971,881,691	2	**1,007,198,076**	977,528,332	3

Statement of Financial Position

As at 31 December	Note	Bank 2018 Rs. '000	Bank 2017 Restated Rs. '000	Bank Change %	Group 2018 Rs. '000	Group 2017 Restated Rs. '000	Group Change %
Equity							
Stated capital/assigned capital	41	**9,400,000**	6,700,000	40	**9,400,000**	6,700,000	40
Statutory reserve fund	42	**3,227,960**	3,002,952	7	**3,227,960**	3,002,952	7
Retained earnings	43	**4,622,080**	1,102,798	319	**5,198,451**	1,679,540	210
Other reserves	44	**26,482,625**	28,289,941	(6)	**26,929,074**	28,757,786	(6)
Total shareholders' equity		**43,732,665**	39,095,691	12	**44,755,484**	40,140,278	11
Non-controlling interests	45	–	–	–	–	–	–
Total equity		**43,732,665**	39,095,691	12	**44,755,484**	40,140,278	11
Total equity and liabilities		**1,037,482,973**	1,010,977,382	3	**1,051,953,560**	1,017,668,610	3
Contingent liabilities and commitments	46	**4,481,397**	18,320,312	(76)	**4,481,397**	18,320,312	(76)
Memorandum information							
Number of employees		**4,512**	4,470				
Number of branches		**255**	253				

Note: Amounts stated are net of impairment and depreciation.

The Notes to the Financial Statements disclosed on pages 258 to 380 are integral parts of these Financial Statements.

Certification
I certify that the above Financial Statements give a true and fair view of the state of affairs of National Savings Bank and the Group as at 31 December 2018 and its profit for the year ended.

Kithsiri Wijeyaratne
Deputy General Manager (Finance and Planning)

The Board of Directors is responsible for the preparation and presentation of these Financial Statements.

Approved and signed for and on behalf of the Board,

Jayaraja Chandrasekera
Chairman

Anil Rajakaruna
Senior Director

Dammika Perera
General Manager/CEO

14 March 2019

Colombo
Sri Lanka

Statement of Changes in Equity

Bank →

	Stated capital/ assigned capital Rs. '000	Statutory reserve fund Rs. '000	Revaluation reserve Rs. '000
Balance as at 1 January 2017	6,200,000	2,522,467	3,296,565
Impact of adopting SLFRS 9	–	–	–
Restated opening balance as at 1 January 2017	6,200,000	2,522,467	3,296,565
Profit for the year 2017	–	–	–
Other comprehensive income (net of tax)	–	–	4,508,480
Total comprehensive income for the year	–	–	4,508,480
Transaction with equity holders, recognised directly in equity			
Transfers to/from reserves during the year	–	480,485	(11,728)
Contribution to consolidated fund-dividend/levy	–	–	–
Contribution to national insurance trust fund	–	–	–
Transfers to unclaimed deposits reserve/issued share capital	500,000	–	–
Total transactions with equity holders	500,000	480,485	(11,728)
Balance as at 31 December 2017	6,700,000	3,002,952	7,793,317
Profit for the year 2018	–	–	–
Other comprehensive income (net of tax)	–	–	–
Total comprehensive income for the year	–	–	–
Transaction with equity holders, recognised directly in equity			
Transfers to/from reserves during the year	–	225,008	–
Contribution to consolidated fund-dividend/levy	–	–	–
Contribution to national insurance trust fund	–	–	–
Transfers to unclaimed deposits reserve/issued share capital	2,700,000	–	–
Total transactions with equity holders	2,700,000	225,008	–
Balance as at 31 December 2018	9,400,000	3,227,960	7,793,317

The Notes to the Financial Statements disclosed on pages 258 to 380 are integral parts of these Financial Statements.

Statement of Changes in Equity

OCI reserve Rs. '000	Cash flow hedging reserve Rs. '000	Other reserves Rs. '000	Retained earnings Rs. '000	Total equity Rs. '000
1,378,818	1,850	16,466,570	2,379,307	32,245,580
–	–	–	(1,232,348)	(1,232,348)
1,378,818	1,850	16,466,570	1,146,959	31,013,232
–	–	–	9,715,961	9,715,961
(33,581)	290,074	–	(2,072,425)	2,692,547
(33,581)	290,074	–	7,643,536	12,408,508
–	–	2,000,000	(2,480,485)	(11,728)
–	–	–	(5,111,114)	(5,111,114)
–	–	–	(96,097)	(96,097)
–	–	392,891	–	892,891
–	–	2,392,891	(7,687,696)	(4,326,048)
1,345,237	291,924	18,859,461	1,102,798	39,095,691
–	–	–	4,500,151	4,500,151
(816,806)	(291,924)	–	(210,861)	(1,319,591)
(816,806)	(291,924)	–	4,289,290	3,180,560
–	–	–	(225,008)	–
–	–	–	(500,000)	(500,000)
–	–	–	(45,002)	(45,002)
–	–	(698,587)	–	2,001,413
–	–	(698,587)	(770,009)	1,456,411
528,430	–	18,160,874	4,622,080	43,732,665

Statement of Changes in Equity

Group →

	Stated capital/ assigned capital Rs. '000	Statutory reserve fund Rs. '000	Revaluation reserve Rs. '000
Balance as at 1 January 2017	6,200,000	2,522,467	3,296,565
Impact of adopting SLFRS 9	–	–	–
Restated opening balance as at 1 January 2017	6,200,000	2,522,467	3,296,565
Profit for the year 2017	–	–	–
Other comprehensive income (net of tax)	–	–	4,508,480
Total comprehensive income for the year	–	–	4,508,480
Transaction with equity holders, recognised directly in equity			
Transfers to/from reserves during the year	–	480,485	(11,728)
Contribution to consolidated fund/dividend-levy	–	–	–
Withholding tax on dividend			
Contribution to national insurance trust fund	–	–	–
Transfers to unclaimed deposits reserve/issued share capital	500,000	–	–
Total transactions with equity holders	500,000	480,485	(11,728)
Balance as at 31 December 2017	6,700,000	3,002,952	7,793,317
Profit for the year 2018	–	–	–
Other comprehensive income (net of tax)	–	–	–
Total comprehensive income for the year	–	–	–
Transaction with equity holders, recognised directly in equity			
Transfers to/from reserves during the year	–	225,008	–
Contribution to consolidated fund-dividend/levy	–	–	–
Withholding tax on dividend	–	–	–
Contribution to national insurance trust fund	–	–	–
Transfers to unclaimed deposits reserve/issued share capital	2,700,000	–	–
Total transactions with equity holders	2,700,000	225,008	–
Balance as at 31 December 2018	9,400,000	3,227,960	7,793,317

The Notes to the Financial Statements disclosed on pages 258 to 380 are integral parts of these Financial Statements.

Statement of Changes in Equity

OCI reserve Rs. '000	Cash flow hedging reserve Rs. '000	Other reserves Rs. '000	Retained earnings Rs. '000	Total equity Rs. '000
1,096,758	1,850	16,960,532	3,708,614	33,786,788
–	–	–	(1,232,437)	(1,232,437)
1,096,758	1,850	16,960,532	2,476,177	32,554,351
–	–	–	9,156,396	9,156,396
131,662	290,074	–	(2,072,155)	2,858,060
131,662	290,074	–	7,084,241	12,014,456
–	–	2,090,699	(2,571,184)	(11,728)
–	–	–	(5,111,114)	(5,111,114)
		–	(102,483)	(102,483)
–	–	–	(96,097)	(96,097)
–	–	392,891	–	892,891
–	–	2,483,590	(7,880,878)	(4,428,531)
1,228,420	291,924	19,444,122	1,679,540	40,140,278
–	–	–	4,500,187	4,500,187
(838,210)	(291,924)	–	(211,258)	(1,341,392)
(838,210)	(291,924)	–	4,288,929	3,158,795
–	–	9	(225,016)	–
–	–	–	(500,000)	(500,000)
–	–	–	–	–
–	–	–	(45,002)	(45,002)
–	–	(698,587)	–	2,001,413
–	–	(698,578)	(770,018)	1,456,411
390,210	–	18,745,544	5,198,451	44,755,484

Statement of Cash Flows

For the year ended 31 December	Bank 2018 Rs. '000	Bank 2017 Rs. '000	Group 2018 Rs. '000	Group 2017 Rs. '000
Cash flows from operating activities				
Interest receipts	**108,759,712**	98,133,606	109,734,424	98,979,184
Interest payments	**(85,287,503)**	(72,290,143)	(86,068,354)	(72,832,914)
Net commission receipts	**864,066**	673,694	863,797	672,040
Trading income	**546,667**	1,044,274	563,393	1,070,689
Payment to employees	**(8,944,003)**	(6,976,586)	(8,983,846)	(7,008,894)
VAT, NBT and DRL on financial services	**(3,372,310)**	(3,291,976)	(3,379,748)	(3,389,080)
Receipts from other operating activities	**283,187**	691,445	281,314	690,422
Payment on other operating activities	**(3,731,927)**	(3,411,069)	(3,697,730)	(3,356,470)
Operating profit before change in operating assets and liabilities	**9,117,889**	14,573,245	9,313,250	14,824,977
(Increase)/decrease in operating assets				
Balances with Central Bank of Sri Lanka	–	–	–	–
Placements with banks	**6,015,111**	(4,455,574)	**6,015,111**	(4,455,574)
Derivative financial instruments	**(3,671,316)**	1,657,805	**(3,671,316)**	1,657,805
Financial assets at FVPL	**(10,995,919)**	14,276,771	**(18,404,137)**	18,659,670
Financial assets at amortised cost – loans and advances	**(48,291,029)**	(63,124,831)	**(49,603,184)**	(62,636,549)
Financial assets at amortised cost – debt and other instrument	**37,230,245**	(34,546,469)	**37,060,618**	(36,397,298)
Proceeds from the sale and maturity of financial investments	–	–	–	–
Other assets	**(4,947,187)**	(4,760,511)	**(4,989,400)**	(4,946,620)
	(24,660,094)	(90,952,809)	**(33,592,308)**	(88,118,565)
Increase/(decrease) in operating liabilities				
Due to Bank	**28,385,587**	28,770,730	**34,111,452**	26,783,430
Derivative financial instruments	**(956,937)**	956,937	**(956,937)**	956,937
Financial liabilities at amortised cost – due to depositors	**101,633,538**	75,188,272	**101,633,538**	75,188,272
Financial liabilities at amortised cost – due to debt securities holders	–	–	–	–
Financial liabilities at amortised cost – due to other borrowers	**2,699,945**	(21,197,538)	**4,894,246**	(22,078,851)
Debt securities issued	**(107,552,900)**	3,480,000	**(107,552,900)**	3,480,000
Other liabilities	**(494,589)**	(1,796,670)	**(533,749)**	(1,760,565)
	23,714,644	85,401,731	**31,595,650**	82,569,223
Net cash generated from operating activities before income tax	**8,172,439**	9,022,167	**7,316,592**	9,275,634
Income tax paid	**(3,365,813)**	(4,328,136)	**(3,506,148)**	(4,383,328)
Net cash (used in)/from operating activities	**4,806,626**	4,694,031	**3,810,444**	4,892,306

Statement of Cash Flows

For the year ended 31 December	Bank 2018 Rs. '000	Bank 2017 Rs. '000	Group 2018 Rs. '000	Group 2017 Rs. '000
Cash flows from investing activities				
Purchase of property, plant and equipment	**(1,742,224)**	(1,049,920)	**(1,742,579)**	(1,052,269)
Proceeds from the sale of property, plant and equipment	**7,474**	7,189	**7,474**	7,189
Net (increase)/decrease in finance instruments at fair value through other comprehensive income	**(1,309,089)**	1,232,344	**(1,114,522)**	1,289,898
Proceeds from the sale and maturity of financial investments	–	–	–	–
Net cash flow from acquisition of investment in subsidiaries and associates	**(800,000)**	–	–	–
Dividends received from investment in subsidiaries and associates	–	172,350	–	–
Net cash (used in)/from investing activities	**(3,843,839)**	361,963	**(2,849,627)**	244,817
Cash flows from financing activities				
Net proceeds from the issue of subordinated debt	–	–	–	–
Repayment of subordinated debt	–	–	–	–
Interest paid on subordinated debt	**(780,000)**	(780,000)	**(780,000)**	(780,000)
Dividend paid to shareholders of the parent company	–	–	–	–
Withholding tax on dividend paid	–	–	–	(84,983)
Contribution to consolidated fund-dividend/levy	**(500,000)**	(5,111,114)	**(500,000)**	(5,111,114)
Net cash from financial activities	**(1,280,000)**	(5,891,114)	**(1,280,000)**	(5,976,097)
Net increase/(decrease) in cash and cash equivalents	**(317,213)**	(835,120)	**(319,183)**	(838,974)
Cash and cash equivalents at the beginning of the year	**3,669,188**	4,504,308	**3,673,741**	4,512,715
Exchange difference in respect of cash and cash equivalent	–	–	–	–
Cash and cash equivalents at the end of the year	**3,351,975**	3,669,188	**3,354,558**	3,673,741
Reconciliation of cash and cash equivalents				
Cash in hand	**699,401**	944,759	**699,411**	944,769
Balances with bank	**2,735,350**	2,892,643	**2,737,745**	2,897,093
Money at call and short notice	–	12,224	–	12,224
Balances with Central banks	–	–	**177**	94
Due to banks	**(82,775)**	(180,439)	**(82,775)**	(180,439)
	3,351,975	3,669,188	**3,354,558**	3,673,741

The Notes to the Financial Statements disclosed on pages 258 to 380 are integral parts of these Financial Statements.

Notes to the Financial Statements

1 — Reporting entity

1.1 Corporate information

National Savings Bank (NSB) is a licensed specialised bank incorporated in 1972 under the National Savings Bank Act No. 30 of 1971 and domiciled in Sri Lanka. It is a licensed specialised bank regulated under the Banking Act No. 30 of 1988 and amendments thereto. The registered office of the Bank is located at No. 255, "Savings House", Galle Road, Colombo 3, Sri Lanka.

The staff strength of the Bank as at 31 December 2018 was 4,512. (2017 – 4,470).

The Bank possesses 255 branches, and 310 ATMs of its service outlets and 653 post offices and 3,409 sub-post offices as its agency network.

1.2 Consolidated financial statements

The Consolidated Financial Statements for the year ended 31 December 2018 comprise of the Bank (Parent) and its fully-owned subsidiary, NSB Fund Management Company Limited.

The Bank is fully-owned by the Government of Sri Lanka. The Bank is the ultimate parent of the Group. The Financial Statements of the Bank and its Subsidiary have a common financial year which ends on 31 December. The Financial Statements of the "Bank" and the "Group" are prepared for the twelve months period ended 31 December each year to be tabled in Parliament.

1.3 Principal activities and nature of operations

GRI 102-2

Bank

The principal activities of the Bank continued to be the promotion of savings among the people of Sri Lanka and profitable investment of savings so mobilised. NSB is providing wide range of solutions such as accepting deposits, corporate and retail credit, trade financing, loans to government projects, pawning, internet banking, SMS banking etc. As per the National Savings Bank Act No. 30 of 1971, the Bank is required to invest in Government Securities a minimum of 60% out of its deposits.

Subsidiary

Bank's fully-owned subsidiary, namely, NSB Fund Management Company Limited, acts as a primary dealer and engaged in dealing in Government Securities.

There were no changes in the nature of the principal activities of the Group during the financial year under review.

2 — Accounting policies

The accounting policies set out below have been applied consistently in all periods when presenting the Financial Statements, unless otherwise indicated. These policies of the Bank are also consistently applied by the Group where applicable and deviations if any have been disclosed accordingly.

2.1 Basis of preparation

2.1.1 Statement of compliance

The Consolidated Financial Statement of the Group and the Separated Financial Statements of the Bank which comprise the Income Statement, Statement of Comprehensive Income, Statement of Financial Position, Statement of Changes in Equity, Statement of Cash Flows, and Notes to the Financial Statements have been prepared and presented in accordance with the Sri Lanka Accounting Standards (LKASs and SLFRSs) issued by The Institute of Chartered Accountants of Sri Lanka and are in compliance with the information required by the Banking Act No. 30 of 1988 and subsequent amendments thereto. These Financial Statements, except for the information in cash flow have been prepared following the accrual basis of accounting.

The formats used in the preparation of Financial Statements and the disclosures made therein also comply with the specified formats prescribed by the Central Bank of Sri Lanka for the preparation, presentation, and publication of Annual Audited Financial Statements of Licensed Banks.

2.1.2 Responsibility for financial statements

The Board of Directors is responsible for the preparation and presentation of the Financial Statements of the Group and the Bank as per the provisions of the National Savings Bank Act No. 30 of 1971 and amendments thereto and the Sri Lanka Accounting Standards.

2.1.3 Approval of Financial Statements by the Board of Directors

The Financial Statements of the Bank and the Group for the year ended 31 December 2018 were approved on 14 March 2019, by the Board of Directors.

2.1.4 Basis of measurement

The Consolidated Financial Statements have been prepared on a historical cost basis, except for the following material items in the Statement of Financial Position, which are measured at fair value.

i. Financial assets measured at fair value though other comprehensive income, (Note 23)
ii. Derivative financial instruments, (Note 19 and 32)
iii. Financial assets and liabilities recognised through profit or loss (Note 20 and 33)
iv. Financial assets designated at fair value through profit or loss, (Note 20)
v. Land and buildings which are measured at cost at the time of acquisition subsequently measured at revalued amounts, which are the fair values at the date of revaluation. (Note 26)
vi. Liability for employee defined benefits obligations are recognised at the present value of the defined benefit obligation less the fair value of the plan assets. (Note 36)

2.1.5 Functional and presentation currency

The Consolidated Financial Statements are presented in Sri Lankan Rupees (Rs.) which is the currency of the primary economic environment in which Group operates and all values are rounded to the nearest thousand Rupees, unless indicated otherwise. There was no change in the Group's presentation and functional currency during the year under review.

2.1.6 Presentation of financial statements

The assets and liabilities of the Bank and the Group presented in the Statement of Financial Position are grouped by their nature and listed in an order that reflects their relative liquidity and maturity pattern.

No adjustment has been made for inflationary factors affecting the Financial Statements. An analysis of maturity patterns of assets and liabilities of the Bank and the Group is presented in Note 54 on pages 372 to 374.

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 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 expenses are 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 Group.

2.1.7 Going concern

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

2.1.8 Materiality and aggregation

Each material class of similar items are presented separately in the Financial Statements. Items of dissimilar nature or functions are presented separately unless they are immaterial as permitted by the Sri Lanka Accounting Standard – LKAS 01 on "Presentation of Financial Statements".

2.1.9 Comparative information

Comparative information including quantitative, narrative, and descriptive information is disclosed in respect of the previous period in the Financial Statements in order to enhance the understanding of the current period's Financial Statements and to enhance the inter period comparability. The comparative information is reclassified where necessary for the better presentation and to conform to the current year's presentation. The comparative figures of 2017 have been restated as per the adoption of SLFRS 9 – "Financial Instrument" Standard. The details are given in Note 51 to the Financial Statements on page 342.

2.1.10 Rounding

The amounts in the Financial Statements have been rounded-off to the nearest rupees thousand, except where otherwise indicated as permitted by the Sri Lanka Accounting Standard – LKAS 1 on "Presentation of Financial Statements" (LKAS 1).

2.1.11 Offsetting

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 liabilities simultaneously. Income and expenses are not offset in the Income Statement, unless required or permitted by an Accounting Standard or Interpretation (issued by the IFRS Interpretations Committee and Standard Interpretations Committee) and as specifically disclosed in the Significant Accounting Policies of the Bank.

2.1.12 Significant accounting judgements, estimates, and assumptions

The preparation of Financial Statements of the Bank and the Group in conformity with Sri Lanka Accounting Standards requires the Management to make judgements, estimates, and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income, and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revise and in any future periods affected.

The significant areas of estimation, critical judgements and assumptions in applying accounting policies that have most significant effect on the amounts recognised in the Financial Statements of the Bank and the Group are as follows:

A. Significant accounting judgement

Information about judgements made in applying accounting policies that have the most significant effects on the amounts recognised in these Financial Statements is included in Note 2.1.12.1 below:

2.1.12.1 Classification of financial assets and liabilities

As per SLFRS 9, the significant accounting policies of the Group provides scope for financial assets to be classified and measured into different categories, namely, at Amortised Cost, Fair Value through Other Comprehensive Income (FVOCI), and Fair Value Through Profit or Loss (FVPL) based on the following criteria:

- The entity's business model for managing the financial assets as set out in Note 2.5.1.4.1 on page 264.
- The contractual cash flow characteristics of the financial assets as set out in Note 2.5.1.4.2 on page 264.

B. Assumptions and estimation uncertainties

Information about assumptions and estimation uncertainties that have a significant risk of resulting in material adjustments are included in Notes 2.1.12.2 to 2.1.12.9 below.

2.1.12.2 Fair value of financial instruments

Where the fair value of financial assets and financial liabilities recorded in the Statement of Financial Position cannot be derived from active markets, they are determined using the valuation techniques that include the use of mathematical models. The inputs to these models are derived from observable market data where possible, but where observable market data are not available, judgement is required to establish fair values.

Methodologies used for valuation of financial instruments and fair value hierarchy are described in more detail in Note No. 55 to the Financial Statements on page 375.

2.1.12.3 Impairment losses on financial assets

The measurement of impairment losses both under SLFRS 9 and LKAS 39 across all categories of financial assets requires judgement, in particular, the estimation of the amount and timing of future cash flows and collateral values when determining impairment losses.

Accordingly, the Group reviews its individually significant loans and advances at each reporting date to assess whether an impairment loss should be provided in the Income Statement. In particular, the Management's 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 hence actual results may differ, resulting in future changes to the impairment allowance made.

The individual impairment provision applies to financial assets evaluated individually for impairment and is based on Management's best estimate of the present value of the future cash flows that are expected to be received. In estimating these cash flows, Management makes judgements about a borrower's financial situation and the net realisable value of any underlying collateral. Each impaired asset is assessed on its merits, and the workout strategy and estimate of cash flows considered recoverable.

A collective impairment provision is established for:

- groups of homogeneous loans and advances that are not considered individually significant; and
- groups of assets that are individually significant but that were not found to be individually impaired.

As per SLFRS 9, the Group's expected credit loss (ECL) calculations are outputs of complex models with a number of underlying assumptions regarding the choice of variable inputs and their interdependencies. Elements of the ECL models that are considered accounting judgements and estimates include:

- The Group's criteria for qualitatively assessing whether there has been a significant increase in credit risk and if so allowances for financial assets measured on a lifetime expected credit loss (LTECL) basis;

- The segmentation of financial assets when their ECL is assessed on a collective basis;
- Development of ECL models, including the various statistical formulas and the choice of inputs;
- Determination of associations between macro-economic inputs, such as GDP growth, inflation, interest rates, exchange rates and unemployment and the effect on Probability of Default (PD), Exposure at Default (EAD), and Loss Given Default (LGD);
- Selection of forward-looking macroeconomic scenarios and their probability weightings, to derive the economic inputs into the ECL models.

2.1.12.4 Revaluation of property, plant and equipment

The freehold land and buildings of the Bank and the Group are reflected at revalued amounts. The Group engaged independent professional valuers to determine the fair value of freehold land and buildings in terms of Sri Lanka Accounting Standard (SLFRS 13) "Fair Value Measurement".

The methods and key assumptions used to determine the fair value of the freehold land and buildings are further explained in Note 2.3 to the Financial Statements.

2.1.12.5 Useful lifetime of property, plant and equipment

The Group reviews the residual values, useful lives and methods of depreciation of property, plant and equipment 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.

2.1.12.6 Impairment of non-financial assets

The Group assess at each reporting date whether there is an indication that an asset other than deferred tax asset, may be impaired. If any indication exists, or when annual impairment testing for an asset is required, the Group estimates the asset's recoverable amount. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount.

2.1.12.7 Deferred tax asset

Deferred tax assets are recognised in respect of tax losses to the extent that it is probable that future taxable profits will be available against which such tax 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 the future tax-planning strategies.

2.1.12.8 Defined benefit obligation

The cost of the defined benefit plans and the present value of their obligations are determined using actuarial valuations. The actuarial valuation involves making assumptions about discount rates, expected rates of return on assets, future salary increases, mortality rates, and future pension increases.

In determining the appropriate discount rate, Management considers the interest rates of Sri Lanka Government Bonds.

The mortality rate is based on publicly available mortality tables. Future salary increases, and pension increases are based on expected future inflation rates and expected future salary increase rate of the Bank.

Due to the long-term nature of these plans, such estimates are subject to significant uncertainty.

2.1.12.9 Provisions, commitments, and contingencies

The Group receives legal claims against it in the normal course of business. Management makes judgements as to the likelihood of any claim succeeding in making provisions. The time of concluding legal claims is uncertain, as is the amount of possible outflow of economic benefits. Timing and cost ultimately depend on the due process in respective legal jurisdiction.

2.2 Changes in accounting policies and transitional disclosures on the adoption of SLFRS 9 in replacing of LKAS 39

2.2.1 SLFRS 9 – Financial Instrument

SLFRS 9 issued in December 2014 replaced LKAS 39 and is applicable for annual reporting periods beginning on or after 1 January 2018. The Group elected as a policy choice permitted under SLFRS 9, to continue to apply hedge accounting in accordance with LKAS 39.

Details of policies under SLFRS 9 are given under Note 2.5 on page 263.

In accordance with the option given in SLFRS 9, the Group has restated comparative information for 2017 for financial instruments within the scope of SLFRS 9. The transitional disclosures are given below:

2.2.1.1 Day 1 impact on equity

Details of Day 1 impact on equity are given in Note 52.6 on page 353.

2.2.1.2 Reconciliation of statement of financial position balances from LKAS 39 to SLFRS 9

Details of reconciliation of Statement of Financial Position balances from LKAS 39 to SLFRS 9 are given in Note 52.2 and 52.3 on pages 345 to 351.

2.2.1.3 Reconciliation of impairment allowance balance from LKAS 39 to SLFRS 9

Details of reconciliation of impairment allowance balance from LKAS 39 to SLFRS 9 are given in Note 52.4 on page 352.

2.2.1.4 Reconciliation of reserve and retained earnings from LKAS 39 to SLFRS 9

Details of reconciliation of reserve and retained earnings from LKAS 39 to SLFRS 9 are given in Note 52.5 on page 353.

2.2.2 SLFRS 7: Financial Instrument – disclosures

To reflect the differences between LKAS 39 and SLFRS 9, SLFRS 7 was updated and Group has adopted it, together with SLFRS 9, effective from 1 January 2018. Changes including transition disclosures, detail quantitative and qualitative information about the expected credit Loss calculations such as the assumption and inputs used are given in Notes 2.5.2 and 52 on page 269 and 342.

2.2.3 SLFRS 15 – Revenue from Contract with Customers

SLFRS 15 was effective from 1 January 2018 and the core principle of SLFRS 15 is that an entity has to recognise revenue to depict the transfer of promised goods or services to customers. This core principle is delivered in a five-step model framework as disclosed below:

- Identify the contracts with a customer
- Identify the performance obligation in the contact
- Determine the transaction price
- Allocate the transaction price to the performance obligations in the contract
- Recognise revenue when the entity satisfies a performance obligation.

Application of this guidance will depend on the facts and circumstances present in a contract with a customer and will require the exercise of judgement. The Bank and the Group did not have any material impact on its fee and commission income with the adoption of SLFRS 15 for the year beginning 1 January 2018.

2.3 Fair value measurement

“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 in the principal or, in its absence, the most advantageous market to which the Group has access at that date. The fair value of a liability reflects its non-performance risk.

The Group measures the fair value of an instrument using the quoted price in an active market for that instrument. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

If there is no quoted pricing in an active market, then the Group uses valuation techniques that maximise the use of relevant observable inputs and minimise the use of unobservable inputs. The chosen valuation technique incorporates all the factors that market participants would consider in pricing a transaction.

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

The Group recognises transfers between levels of the fair value hierarchy as of the end of the reporting period during which the change has occurred.

A fair value measurement of a non-financial asset considers 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. External professional valuers are involved for valuation of significant assets such as land and building.

An analysis of fair value measurement of financial assets and liabilities is provided in Note 55 on pages 375 to 380.

2.4 Significant accounting policies – General

2.4.1 Basis of consolidation

The Financial Statements of the Bank and the Group comprise the Financial Statements of the Bank and its Subsidiary in terms of the SLFRS 10 – “Consolidated Financial Statements” and LKAS 27 – “Separate Financial Statements”.

2.4.1.1 Subsidiary

The Financial Statements of the subsidiary is fully consolidated from the date on which control is transferred to the Bank and continued to be consolidated until the date when such control ceases. The control exists where the Bank has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The Financial Statements of the Bank's Subsidiary for the purpose of consolidation are prepared for the same reporting period as that of National Savings Bank, using consistent accounting policies.

2.4.1.2 Transactions eliminated on consolidation

All intra-group balances, income and expenses and unrealised gains and losses resulting from intra-group transactions are eliminated in full in preparing the Consolidated Financial Statements. Refer Note 47 (b) – transaction with subsidiary company on page 338.

2.4.1.3 Foreign currency transactions and balances

All foreign currency transactions are translated into the functional currency, which is Sri Lankan Rupees, using the exchange rates prevailing at the dates on which the transactions were affected.

Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to Sri Lankan Rupees using the middle exchange rate ruling at that date. All exchange differences arising on the settlement of monetary items or on translating monetary items at rates different to those at which they are initially recorded are recognised in the Income Statement in the period in which they arise.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates at the dates of the initial transactions. Non-monetary items measured at fair value in foreign currency are translated using the exchange rates at the date when the fair value was determined.

The Statement of Financial Position of Foreign Currency Banking Unit is translated to Sri Lankan Rupees at the middle rate of exchange ruling at the reporting date. The transactions of the Foreign Currency Banking Unit have been recorded in accordance with the above policy and the resulting gains/losses are recognised in the Income Statement.

2.5 Significant accounting policies – Recognition of assets and liabilities

Financial instruments

SLFRS 9 – "Financial Instrument" replaces LKAS 39 for annual periods on or after 1 January 2018. The Bank elected, as a policy choice permitted under SLFRS 9, to continue to apply hedge accounting in accordance with LKAS 39.

The Bank and the Group have restated comparative information for 2017 for financial instruments in the scope of SLFRS 9. Therefore, the comparative information for 2017 is reported under SLFRS 9.

2.5.1 Financial instruments – initial recognition, classification and subsequent measurement

2.5.1.1 Date of recognition

The Group initially recognises loans and advances, deposits and subordinated liabilities, etc., on the date on which they are originated. Loans and advances to customers are recognised when funds are transferred to the customers' accounts. The Bank recognises balances due to depositors when funds are transferred to the Bank. All other financial instruments (including regular-way purchases and sales of financial assets) are recognised on the trade date, which is the date on which the Group becomes a party to the contractual provisions of the instrument.

2.5.1.2 Recognition and initial measurement of financial instruments

The classification of financial instruments at initial recognition depends on their contractual terms and the business model for managing the instruments, as described in Notes 2.5.1.4.1 and 2.5.1.4.2 on page 264.

Financial instruments are initially measured at their fair value (as defined in Note 55), except in the case of financial assets and financial liabilities recorded at FVPL, transaction costs are added to, or subtracted from, this amount. Trade receivables are measured at the transaction price. When the fair value of financial instruments at initial recognition differs from the transaction price, the Bank and the Group accounts for the Day 1 profit or loss, as described below.

Notes to the Financial Statements

2.5.1.3 "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 fair value based on a valuation technique whose variables include only data from observable markets, the Group immediately recognises the difference between the transaction price and fair value (a "Day 1" profit or loss). 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 Statement of Comprehensive Income when the inputs become observable, or when the instrument is derecognised. The "Day 1 loss" arising in the case of loans granted to employees at concessionary rates under uniformly applicable schemes is deferred and amortised using Effective Interest Rates (EIR) in "Interest Income and Personnel Expenses" over the remaining service period of the employees or tenure of the loan whichever is shorter.

2.5.1.4 Classification and subsequent measurement of financial assets

From 1 January 2018, the Bank classifies all of its financial assets based on the business model for managing the assets and the asset's contractual terms, measured at either:

- Amortised cost,
- Fair Value though Other Comprehensive Income (FVOCI),
- Fair Value through Profit or Loss (FVPL)

The Bank and the Group classifies and measures its derivative and trading portfolio at FVPL as explained in Note 2.5.1.6. The Bank may designate financial instruments at FVPL, if so doing eliminates or significantly reduces measurement or recognition inconsistencies.

Up to 31 December 2017 as per LKAS 39, the Group classified its financial assets into one of the following categories:

- Financial assets at fair value through profit or loss (FVPL), and within this category
  - Held for trading
  - Designated at fair value through profit or loss
- Loans and receivables
- Held to maturity
- Available for sale

Details of the impact on reclassification and measurement from LKAS 39 to SLFRS 9 are disclosed in transition disclosures given in Note 52 on pages 342 to 354.

Detailed analysis of classification and subsequent measurement of financial assets is given in Note 15 on page 289.

2.5.1.4.1 Business model assessment

The Bank and the Group determines its business model at the level that best reflects how it manages groups of financial assets to achieve its business objective.

The Bank's business model is not assessed on an instrument-by-instrument basis, but at a higher level of aggregated portfolios and is based on observable factors such as:

- How the performance of the business model and the financial assets held within that business model are evaluated and reported to the entity's Key Management Personnel,
- The risks that affect the performance of the business model (and the financial assets held within that business model) and, in particular, the way those risks are managed,
- How managers of the business are compensated, (for example, whether the compensation is based on the fair value of the assets managed or on the contractual cash flows collected)
- The expected frequency, value and timing of sales are also important aspects of the Bank's assessment.

The business model assessment is based on reasonably expected scenarios without taking "worst case" or "stress case" scenarios into account. If cash flows after initial recognition are realised in a way that is different from the Bank's original expectations, the Bank does not change the classification of the remaining financial assets held in that business model but incorporates such information when assessing newly originated or newly purchased financial assets going forward.

2.5.1.4.2 Assessment of whether contractual cash flows are solely payments of principal and interest (SPPI test)

As a second step of its classification process, the Bank assesses the contractual terms of financial to identify whether they meet the SPPI test.

"Principal" for the purpose of this test is defined as the fair value of the financial asset at initial recognition and may change over the life of the financial asset (for example, if there are repayments of principal or amortisation of the premium/discount).

The most significant elements of interest within a lending arrangement are typically the consideration for the time value of money and credit risk. To make the SPPI assessment, the Bank applies judgement and considers relevant factors such as the currency in which the financial asset is denominated, and the period for which the interest rate is set.

In contrast, contractual terms that introduce a more than *de minimis* exposure to risks or volatility in the contractual cash flows that are unrelated to a basic lending arrangement do not give rise to contractual cash flows that are solely payments of principal and interest on the amount outstanding. In such cases, the financial asset is required to be measured at FVPL.

Refer Notes 2.5.1.4.3 to 2.5.1.4.5 below for details on different types of financial assets recognised on the Statement of Financial Position.

2.5.1.4.3 Financial assets measured at amortised cost →

A financial asset is measured at amortised cost if it meets both of the following conditions and is not designated as at FVPL:

- The asset is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Financial assets measured at amortised cost are given below:

(a) Cash and cash equivalents →

Details of "Cash and cash equivalents" are given in Note 16 on page 292.

(b) Balances with central banks →

Details of "Balances with central banks" are given in Note 17 on page 292.

(c) Placement with bank →

Details of "Placement with banks" are given in Note 18 on page 292.

(d) Financial assets at amortised cost – Loan and advances →

Details of "Loan and advances" are given in Note 21 on page 299.

(e) Financial assets at amortised cost – Debt and other instruments →

Details of "Debt and other instruments" are given in Note 22 on page 304.

2.5.1.4.4 Financial assets measured at FVOCI →

Financial assets at FVOCI include debt and equity instruments measured at fair value through other comprehensive income.

Financial assets measured at FVOCI are given in Notes (a) and (b) below:

(a) Debt instruments measured at FVOCI →

Debt instruments are measured at FVOCI if they are held within a business model whose objective is to hold for collection of contractual cash flows and for selling financial assets, where the asset's cash flows represent payments that are solely payments of principal and interest on principal outstanding.

Details of "Debt instruments at FVOCI" are given in Note 23 on pages 305 to 309.

(b) Equity instruments designated at FVOCI →

Upon initial recognition, the Group elects to classify irrevocably some of its equity investments held for strategic and statutory purposes as equity instruments at FVOCI. Details of "Equity instruments at FVOCI" are given in Note 23 on pages 305 to 309.

2.5.1.4.5 Financial assets measured at FVPL →

As per SLFRS 9, all financial assets other than those classified at amortised cost or FVOCI are classified and measured at FVPL. Financial assets at fair value through profit or loss include financial assets that are held for trading or managed and whose performance is evaluated on a fair value basis as they are neither held to collect contractual cash flows nor held both to collect contractual cash flows and to sell financial assets and financial assets designated upon initial recognition at fair value through profit or loss which are discussed in below:

(a) Financial assets designated at fair value through profit or loss →

Financial assets designated at fair value through profit or loss are recorded in the Statement of Financial Position (SOFP) 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 earned is accrued in "Interest income", using the EIR, while dividend income is recorded in "Other operating income" when the right to receive the payment has been established.

The Group do not have any designated financial assets upon initial recognition as fair value through profit or loss as at the end of the reporting period.

2.5.1.5 Classification and subsequent measurement of financial liabilities

As per SLFRS 9, the Group classifies financial liabilities, other than financial guarantees and loan commitments into one of the following categories:

- Financial liabilities at fair value through profit or loss, and within this category as –
  - Held for trading; or
  - Designated at fair value through profit or loss;
- Financial liabilities measured at amortised cost.

The subsequent measurement of financial liabilities depends on their classification. SLFRS 9, largely retains the existing requirements in LKAS 39 for the classification of financial liabilities.

2.5.1.5.1 Financial liabilities at fair value through profit or loss

The Group do not have any designated financial liabilities as at fair value through profit or loss as at the end of the reporting period.

2.5.1.5.2 Financial liabilities at amortised cost

Financial liabilities issued by the Group that are not designated at FVPL are classified as financial liabilities at amortised cost under “Due to banks”, “Due to depositors”, “Due to debt securities holders”, “due to other borrower”, or “Debt security issued” as appropriate, where the substance of the contractual arrangement results in the Group 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 asset for a fixed number of own equity shares. The Group classifies capital instruments as financial liabilities or equity instruments in accordance with the substance of the contractual terms of the instrument.

After initial recognition, such financial liabilities are subsequently measured at amortised cost using the EIR (Effective Interest Rate) method. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the EIR.

The EIR amortisation is included in “interest expense” in the Income Statement. Gains and losses too are recognised in the Income Statement when the liabilities are derecognised as well as through the EIR amortisation process.

(a) Due to banks

Details of “Due to banks” are given in Note 31 on page 318.

(b) Due to depositors

Details of “Due to depositors” are given in Note 34 on page 320.

(c) Due to debt securities holders

Details of “Due to debt securities holders” are given in Note 34 on page 320.

(d) Due to other borrowers

Details of “Due to other borrowers” are given in Note 34 on page 320.

(e) Debt securities issued

Details of “Debt securities issued” are given in Note 35 on page 321.

2.5.1.6 Derivative assets and liabilities

Derivative assets and liabilities are broadly classified into derivative recorded at fair value through profit or loss and derivatives held for risk management purposes.

2.5.1.6.1 Derivative recorded at fair value through profit or loss

A derivative is a financial instrument or other contract with all three of the following characteristics:

- Its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided that, in the case of a non-financial variable, it is not specific to a party to the contract (i.e. the “underlying”).
- It requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts expected to have a similar response to changes in market factors.
- It is settled at a future date.

The Bank enters into derivative transactions with various counterparties. These include interest rate swaps, futures, credit default swaps, cross-currency swaps, forward foreign exchange contracts and options on interest rates, foreign currencies and equities. Derivatives are recorded at fair value and carried as assets when their fair value is positive and as liabilities when their fair value is negative. The notional amount and fair value of such derivatives are disclosed separately in Note 19. Changes in the fair value of derivatives are included in net trading income unless hedge accounting is applied. Hedge accounting disclosures are provided in Note 19 on pages 293 to 295.

2.5.1.6.2 Derivatives held for risk management purposes and hedge accounting →

Derivatives held for risk management purposes include all derivative assets and liabilities that are not classified as trading assets and liabilities. Derivatives held for risk management purposes are measured at fair value in the Statement of Financial Position (SOFP).

2.5.1.6.2.1 Fair value hedges →

When a derivative is designated as the hedging instrument in a hedge of the change in fair value of a recognised asset or liability or a firm commitment that could affect the profit or loss, changes in the fair value of the derivative are recognised immediately in profit or loss in the same line item as the hedged item that is attributable to the hedged risk.

If the hedging derivative expires or is sold, terminated or exercised, or the hedge no longer meets the criteria for fair value hedge accounting, or the hedge designation is revoked, then hedge accounting is discontinued prospectively. However, if the derivative is novated to a central counterparty by both parties as a consequence of laws or regulations without changes in its terms except for those are necessary for the novation, then the derivative is not considered as expired or terminated.

Any adjustment up to the point of discontinuation to a hedged item for which the effective interest method is used is amortised to profit or loss as part of the recalculated EIR of the item over its remaining life.

2.5.1.6.2.2 Cash flow hedges →

When a derivative is designated as the hedging instrument in a hedge of the variability in cash flows attributable to a particular risk associated with a recognised asset or liability that could affect the profit or loss, the effective portion of changes in the fair value of the derivative are recognised in OCI and presented in the hedging reserve within equity. Any ineffective portion of changes in the fair value of the derivative is recognised immediately in profit or loss.

The amount recognised in OCI is reclassified to profit or loss as a reclassification adjustment in the same period as the hedged cash flows affect profit or loss, and in the same line item in the Statement of Profit or Loss and OCI.

If the hedging derivative expires or is sold, terminated, or exercised, or the hedge no longer meets the criteria for cash flow hedge accounting, or the hedge designation is revoked, then hedge accounting is discontinued prospectively. However, if the derivative is novated to a central counterparty by both parties as a consequence of laws or regulations without changes in its terms except for those are necessary for the novation, then the derivative is not considered as expired or terminated.

2.5.1.6.2.3 Embedded derivatives →

An embedded derivative is a component of a hybrid instrument that also includes a non-derivative host contract with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative. An embedded derivative cause some or all of the cash flows that otherwise would be required by the contract to be modified according to a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided that, in the case of a non-financial variable, it is not specific to a party to the contract. A derivative that is attached to a financial instrument, but is contractually transferable independently of that instrument, or has a different counterparty from that instrument, is not an embedded derivative, but a separate financial instrument.

As per SLFRS 9, derivatives may be embedded in another contractual arrangement (a host contract). The Group treats derivatives embedded in financial liabilities and non-financial host contracts as separate derivatives if –

- The host contract is not itself carried at FVPL;
- The terms of the embedded derivative would meet the definition of a derivative if they were contained in a separate contract; and
- The economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract.

As at the reporting date the Group do not have embedded derivatives.

2.5.1.7 Reclassification of financial assets and liabilities →

As per SLFRS 9, financial assets are not reclassified subsequent to their initial recognition, except and only in those rare circumstances when the Group changes its objective of the business model for managing such financial assets which may include the acquisition, disposal, or termination of a business line.

Financial liabilities are not reclassified as such reclassifications are not permitted by SLFRS 9.

From 1 January 2018, the Bank and the Group have not reclassified its financial assets subsequent to their initial recognition, apart from the exceptional circumstances in which the Bank acquires, disposes of, or terminates a business line. The Bank did not reclassify any of its financial assets or liabilities as at 1 January 2018 other than the re-arrangement of financial instruments to restate the comparative figure in 2017.

2.5.1.7.1 Measurement of reclassification of financial assets →

2.5.1.7.1.1 Reclassification of financial instruments at fair value through profit or loss →

- to fair value through other comprehensive income

  The fair value on reclassification date becomes the new gross carrying amount. The EIR is calculated based on the new gross carrying amount. Subsequent changes in the fair value is recognised in OCI.

- to amortised cost

  The fair value on reclassification date becomes the new carrying amount. The EIR is calculated based on the new gross carrying amount.

2.5.1.7.1.2 Reclassification of financial instruments at "Fair value through other comprehensive income" →

- to fair value through profit or loss

  The accumulated balance in OCI is reclassified to profit and loss on the reclassification date.

- to amortised cost

  The financial asset is reclassified at fair value. The cumulative balance in OCI is removed and is used to adjust fair value on the reclassification date. The adjusted amount becomes the amortised cost.

EIR determined at initial recognition and gross carrying amount are not adjusted as a result of reclassification.

2.5.1.7.1.3 Reclassification of financial instruments at "amortised cost" →

- to Fair value through other comprehensive income

  The asset is remeasured to fair value, with any difference recognised in OCI. EIR determined at initial recognition is not adjusted as a result of reclassification.

- to fair value through profit or loss

  The fair value on the reclassification date becomes the new carrying amount. The difference between amortised cost and fair value is recognised in profit and loss.

2.5.1.8 Derecognition of financial assets and financial liabilities →

2.5.1.8.1 Financial assets →

The Group derecognises a financial asset (or where applicable a part thereof) when the contractual rights to the cash flows from the financial asset expire or it transfers the rights to receive the contractual cash flows in a transaction in which substantially all risks and rewards of ownership of the financial asset are transferred or in which the Group neither transfers nor retains substantially all risks and rewards of ownership and it does not retain control of the financial asset.

On derecognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset derecognised) and the sum of the consideration received (including any new asset obtained less and new liability assumed) and any cumulative gain or loss that had been recognised in OCI is recognised in profit or loss.

However, cumulative gain/loss recognised in OCI in respect of equity investment securities designated as at FVOCI is not recognised in profit or loss on derecognition of such securities as per SLFRS 9. Any interest in transferred financial assets that qualify for derecognition that is created or retained by the Group is recognised as a separate asset or liability.

The Group enters into transactions whereby it transfers assets recognised on its SOFP, but retains either all or substantially all risks and rewards of the transferred assets or a portion of them. In such cases, the transferred assets are not derecognised. When assets are sold to a third party with a concurrent total rate of return swap on the transferred assets, the transaction is accounted for as a secured financing transaction similar to sale and repurchase transactions because the Group retains all or substantially all risks and rewards of ownership of such assets.

When the Group has transferred its right 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 Group's continuing involvement in the asset. In that case, the Group also recognises an associated liability. The transferred asset and the associated liability are measured on the basis that reflected the rights and obligations that the Group has retained.

2.5.1.8.2 Financial liabilities →

The Group derecognises a financial liability when its contractual obligations are discharged, cancelled, or expired.

2.5.1.9 Modification of financial assets and financial liabilities

2.5.1.9.1 Financial assets

If the terms of a financial asset are modified, the Group evaluates whether the cash flows of the modified asset are substantially different. If the cash flows are substantially different, then the contractual rights to cash flows from the original financial asset are deemed to have expired. In this case, the original financial asset is derecognised, and a new financial asset is recognised at fair value.

As per SLFRS 9, if the cash flows of the modified asset carried at amortised cost are not substantially different, then the modification does not result in derecognition of the financial asset. In this case, the Group recalculates the gross carrying amount of the financial asset and recognises the amount arising from adjusting the gross carrying amount as a modification gain or loss in profit or loss. If such a modification is carried out because of financial difficulties of the borrower, then the gain or loss is presented together with impairment losses. In other cases, it is presented as interest income.

2.5.1.9.2 Financial liabilities

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. In this case, a new financial liability based on the modified terms is recognised at fair value. The difference between the carrying amount of the financial liability extinguished and the new financial liability with modified terms is recognised in profit or loss.

2.5.1.10 Offsetting of financial instruments

Financial assets and financial liabilities are offset, and the net amount reported in the SOFP 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 assets and settle the liabilities simultaneously.

2.5.1.11 Amortised cost and gross carrying amount

The “amortised cost” of a financial asset or financial liability is the amount at which the financial asset or financial liability is measured on initial recognition minus the principal repayments, plus or minus the cumulative amortisation using the EIR method of any difference between that initial amount and the maturity amount and, for financial assets, adjusted for any ECL allowance.

The “gross carrying amount of a financial asset” is the amortised cost of a financial asset before adjusting for any ECL allowance.

2.5.1.12 Fair value of financial instruments

Fair value measurement of financial instruments including the fair value hierarchy is explained in Notes 2.3 and 55 on pages 262 and 375.

2.5.2 Impairment of financial assets

2.5.2.1 Impairment of financial assets (Policies applicable before 1 January 2018)

The Group assesses at each reporting 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 a impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated.

Objective evidence of impairment includes indications that the borrower or a group of borrowers is experiencing significant financial difficulty, the probability that they will enter bankruptcy or other financial restructuring, default or delinquency in interest or principal payments and also other observable data indicating that there is a measurable decrease in the estimated future cash flows, or economic conditions that correlate with defaults.

Objective evidence that financial assets (including equity securities) are impaired can include –

- Significant financial difficulty of the borrower or issuer,
- Reschedulement of credit facilities,
- Adverse financial ratio and gearing ratios,
- Downgrading of the external credit rating,
- Default or delinquency by a borrower,
- Restructuring of a loan or advance by the Group on terms that the Group would not otherwise consider,
- Indications that a borrower or issuer will enter bankruptcy,
- The disappearance of an active market for a security, or
- Other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group or economic conditions that correlate with defaults in the Group.

In general, the Group considers a decline of 20% to be "significant" and a period of six months to be "prolonged". However, in specific circumstances a smaller decline or a shorter period may be appropriate.

i. **Impairment of financial assets carried at amortised cost**

Details of the individual and collective assessment of impairments are given in Note 21 on page 299.

ii. **Impairment of available-for-sale financial investments**

Details of the Impairment of available-for-sale financial investments is given in Note 23 on page 305.

2.5.2.2 Impairment of financial assets (Policy applicable from 1 January 2018) →

2.5.2.2.1 Individual assessment of impairment →

For financial assets above a predetermined threshold (i.e. for individually significant financial assets), if there is objective evidence that an impairment loss had been incurred, the amount of the loss was measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that had not been incurred).

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 was probable. Detail of Individual assessment of impairment are given in Note 21. (d) on page 301.

2.5.2.2.2 Individually significant assessment and not impaired individually →

Loans which are individually significant but not impaired will be assessed collectively for impairment either under Stage 1 or Stage 2 based on the criteria whether there has been significant credit deterioration since origination.

While establishing significant credit deterioration Bank will consider the following criteria's:

- Other changes in the rates or terms of an existing financial instrument that would be significantly different if the instrument was newly originated.
- Significant changes in external market indicators of credit risk for a particular financial instrument or similar financial instrument.
- Other information related to the borrower, such as changes in the price of a borrower's debt/equity instrument.
- An actual/expected internal credit rating downgrade for the borrower or decrease in behavioural score used to assess credit risk internally.
- Existing or forecast adverse changes in business, financial or economic condition that are expected to cause significant change in the borrower's ability to meet its obligation.
- An actual or expected significant change in the operating results of the borrower in relating to actual/expected decline in revenue, increase in operating risk, working capital deficiency, decrease in asset quality, increase in gearing, liquidity management problems.
- Significant increase in credit risk on other financial instruments of the same borrower.
- An actual or expected significant adverse change in the regulatory, economic, or technological environment of the borrower that result in a significant change in the borrower's ability to meet the debt obligation.

2.5.2.2.3 Overview of the ECL principles →

The adoption of SLFRS 9 has fundamentally changed the Bank's loan loss impairment method by replacing LKAS 39's incurred loss approach with a forward-looking ECL approach.

From 1 January 2018, the Bank has been recording the allowance for expected credit losses for all loans and other debt financial assets not held at FVPL, together with loan commitments and financial guarantee contracts, in this section all referred to as "financial instruments". Equity instruments are not subject to impairment under SLFRS 9.

The ECL allowance is based on the credit losses expected to arise over the life of the asset (the lifetime expected credit loss or LTECL), unless there has been no significant increase in credit risk since origination, in which case, the allowance is based on the 12 months' expected credit loss (12mECL). The Bank's policies for determining if there has been a significant increase in credit risk are set out in Note 2.5.2.2.7 on page 272.

The 12mECL is the portion of LTECLs that represent the ECLs that result from default events on a financial instrument that are possible within the 12 months after the reporting date. Both LTECLs and 12mECLs are calculated on either an individual basis or a collective basis, depending on the nature of the underlying portfolio of financial instruments.

The Bank has established a policy to perform an assessment, at the end of each reporting period, of whether a financial instrument's credit risk has increased significantly since initial recognition, by considering the change in the risk of default occurring over the remaining life of the financial instrument.

Based on the above process, the Bank groups its loans into Stage 1, Stage 2 and Stage 3 as described below:

Stage 1

- When loans are first recognised, the Bank recognises an allowance based on 12mECLs. Stage 1 loans also include facilities where the credit risk has improved, and the loan has been reclassified from Stage 2.

Stage 2

- When a loan has shown a significant increase in credit risk since origination, the Bank records an allowance for the LTECLs. Stage 2 loans also include facilities, where the credit risk has improved, and the loan has been reclassified from Stage 3.
- 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.

Stage 3

- Credit facilities where contractual payments of a customer are more than 90 days past due, subject to the rebuttable presumption as stated in SLFRS 9.
- All restructured loans, which are restructured more than twice.
- All rescheduled loans.
- All credit facilities/customers classified as non-performing as per CBSL Directions.
- When the risk rating of a customer or an instrument has been downgraded to B+ by an external credit rating agency and/or when there is a two-notch downgrade in the Bank's internal rating system.
- Non-performing credit facilities/customers significant increase in credit risk (refer Note 2.5.2.2.7).

For financial assets for which the Bank has no reasonable expectations of recovering either the entire outstanding amount, or a proportion thereof, the gross carrying amount of the financial asset is reduced. This is considered a (partial) derecognition of the financial asset.

2.5.2.2.4 The calculation of ECL

The Bank calculates ECL to measure the expected cash shortfalls, discounted at an approximation to the EIR. A cash shortfall is the difference between the cash flows that are due to an entity in accordance with the contract and the cash flows that the entity expects to receive.

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

- **Probability of Default (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.

- **Exposure at Default (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 principal and interest, whether scheduled by contract or otherwise, expected draw downs on committed facilities, and accrued interest from missed payments.

- **Loss Given Default (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 lender would expect to receive, including from the realisation of any collateral. It is usually expressed as a percentage of the EAD.

The maximum period for which the credit losses are determined is the contractual life of a financial instrument unless the Bank has the legal right to call it earlier.

Impairment losses and releases are accounted for and disclosed separately from modification losses or gains that are accounted for as an adjustment of the financial asset's gross carrying value

The mechanics of the ECL method are summarised below:

- **Stage 1**

  The 12mECL is calculated as the portion of LTECLs that represent the ECLs that result from default events on a financial instrument that are possible within the 12 months after the reporting date. The Bank calculates the 12mECL allowance based on the expectation of a default occurring in the 12 months following the reporting date. These expected 12-month default probabilities are applied to a forecast EAD and multiplied by the expected LGD and discounted by an approximation to the original EIR.

- **Stage 2**

  When a loan has shown a significant increase in credit risk since origination, the Bank records an allowance for the LTECLs. The mechanics are similar to those explained above, but PDs and LGDs are estimated over the lifetime of the instrument. The expected cash shortfalls are discounted by an approximation to the original EIR.

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- **Stage 3**

  For loans considered credit-impaired, the Bank recognises the lifetime expected credit losses for these loans. The method is similar to that for Stage 2 assets, with the PD set at 100%.

2.5.2.2.5 Debt instruments measured at fair value through OCI

The ECLs for debt instruments measured at FVOCI do not reduce the carrying amount of these financial assets in the Statement of Financial Position, which remains at fair value. Instead, an amount equal to the allowance that would arise if the assets were measured at amortised cost is recognised in OCI as an accumulated impairment amount, with a corresponding charge to profit or loss. The accumulated loss recognised in OCI is recycled to the profit and loss upon derecognition of the assets.

2.5.2.2.6 Forward–looking information

In its ECL models, the Bank relies on a broad range of forward-looking information as economic inputs, such as:

- GDP growth
- Unemployment rates
- Inflation rates
- Exchange rates
- Interest rates

The inputs and models used for calculating ECLs may not always capture all characteristics of the market at the date of the Financial Statements. To reflect this, qualitative adjustments or overlays are occasionally made as temporary adjustments when such differences are significantly material.

2.5.2.2.7 Significant increase in credit risk

The Bank continuously monitors all assets subject to ECL, in order to determine whether an instrument or a portfolio of instruments is subject to 12mECL or LTECL, the Bank assess whether there has been a significant increase in credit risk since initial recognition. The Bank considers the significant increase in credit risk when one of the following factors/ condition are met.

- When contractual payments of a customer are more than 30 days past due (subject to the rebuttable presumption in the SLFRS 9)
- When the risk rating of a customer or an instrument has been downgraded to B+ by an external credit rating agency
- Restructured facilities
- Secondary qualitative indicators triggering a significant increase in credit risk for an asset, such as moving a customer/facility to watch list
- When reasonable and supportable forecasts of future economic conditions directly affect the performance of a customer/group of customers, portfolios or instruments
- When there is a significant change in the geographical locations or natural catastrophes that directly impact the performance of a customer/group of customers or an instrument
- When the value of collateral is significantly reduced and/or realisability of collateral is doubtful
- When a customer is subject to litigation, that significantly affects the performance of the credit facility
- Frequent changes in the Senior Management of an institutional customer
- Delay in the commencement of business operations/projects by more than two years from the originally agreed date
- 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
- A fall of 50% or more in the turnover and/or profit before tax of the customer when compared to the previous year; and
- Erosion in net-worth by more than 25% when compared to the previous year

2.5.2.2.8 Definition of default and credit impaired assets

The Group considers loans and advances to other customers be defaulted when:

- The borrower is unlikely to pay its obligations to the Group in full, without recourse by the Group to actions such as realising security (if any is held); or
- The borrower becomes 90 days past due on its contractual payments.

In addition, the Group classifies the financial investments under Stage 3 when the external credit rating assigned to the particular investment is "default".

2.5.3 Property, plant and equipment (PPE)

Details of property, plant and equipment are given in Note 26 on page 310.

2.5.4 Intangible assets

Details of intangible assets are given in Note 28 on page 316.

2.5.5 Impairment of non-financial assets

The Group assess at each reporting date whether there is an indication that an asset other than deferred tax asset, may be impaired. If any indication exists, or when annual impairment testing for an asset is required, the Group estimates the asset's recoverable amount. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount.

2.5.6 Retirement benefit obligation

2.5.6.1 Defined benefit pension plans

2.5.6.1.1 Staff pension fund – I

The Bank operates a defined benefit pension plan, for the permanent staff members who have joined the Bank prior to 1 October 1995, which requires contributions to be made to a separately administered fund. The cost of providing benefits under the defined benefit pension plan – I is determined using the Projected Unit Credit actuarial valuation method. Actuarial gains and losses are recognised in the Other Comprehensive Income in the period in which they arise.

The defined benefit asset or liability is calculated as the present value of the defined benefit obligation less past service costs not yet recognised and less the fair value of planned assets out of which the obligations are to be settled directly, less actuarial losses not yet recognised. The value of the defined benefit liability is borne by the Bank and recognised in the profit or loss. The value of any asset is restricted to the sum of any actuarial losses and past service cost not yet recognised and the present value of any economic benefits available in the form of refunds from the plan or reductions in the future contributions to the plan.

The latest actuarial valuation was carried out as of 31 December 2018, by Mr Piyal S Gunatilleke FSA (USA), Member of the American Academy of Actuaries and Consulting Actuaries.

The principal financial assumptions used in the valuation as at 31 December 2018 are as follows:

Interest/discount rate	12.00% p.a.
Increase in cost of living allowances	4.50% p.a.
Increase in average basic salary	6.50% p.a.

The assets of the fund are held separately from these of the Bank and are independently administrated by the Trustees as per the provisions of the Trust Deed and are subject to annual audit by Independent External Auditors. The Financial Statements as well as the Auditor's Report are tabled and reviewed by the Board of Trustees. They are also submitted for review of the disclosure of the Bank, as the Bank has an obligation of ensuring that funding is made at optimum levels. Pension is payable monthly as long as the participant is alive.

Details of Staff Pension Fund – I are given in Note 36. (a) 1. on pages 323 to 325.

2.5.6.1.2 Unfunded pension liability

The past service cost not funded is recognised in Other Comprehensive Income immediately upon actuarial valuation. The actuarial valuation as at 31 December 2018 indicated a past service cost deficit of Rs. 2,596 Mn. which has been provided in full. The details of Unfunded Pension Liability are given in Note 36. (a) 1 on pages 323 to 325.

2.5.6.1.3 Staff Pension Fund – II

The Bank established and operates a defined benefit pension plan, for the permanent staff members who have joined the Bank on or after 1 October 1995, which requires the Bank to monthly contribute 12% of members' gross salary to a separately administered fund. The cost of providing benefits under the defined benefit pension plan is determined using the Projected Unit Credit actuarial valuation method. Actuarial gains and losses are recognised in the Other Comprehensive Income in the period in which they arise.

The defined benefit asset or liability is calculated as the present value of the defined benefit obligation less past service costs not yet recognised and less the fair value of planned assets out of which the obligations are to be settled directly, less actuarial losses not yet recognised. The value of the defined benefit liability is borne by the Bank and recognised in the profit or loss. The value of any asset is restricted to the sum of any actuarial losses and past service cost not yet recognised and the present value of any economic benefits available in the form of refunds from the plan or reductions in the future contributions to the plan.

The latest actuarial valuation was carried out as of 31 December 2018, by Mr Piyal S Gunatilleke FSA (USA), Member of the American Academy of Actuaries and Consulting Actuaries.

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The principal financial assumptions used in the valuation as at 31 December 2018 are as follows:

Interest/discount rate	12.00% p.a.
Increase in cost of living allowances	4.50% p.a.
Increase in average basic salary	6.50% p.a.

The assets of the fund are held separately from these of the Bank and are independently administrated by the Trustees as per the provisions of the Trust Deed and are subject to annual audit by independent external auditors. The Financial Statements as well as the Auditor's Report are tabled and reviewed by the Board of Trustees. They are also submitted for review of the disclosure of the Bank, as the Bank has an obligation of ensuring that funding is made at optimum levels. Pension is payable monthly as long as the participant is alive.

Details of Staff Pension Fund – II are given in Note 36. (a) 2. on pages 325 to 327.

2.5.6.1.4 Widows'/Widowers' and Orphans Pension Fund

Effective from 2013 December, the Bank has established a "Widows'/Widowers' and Orphans" Pension Scheme for the members of Pension scheme – II. Members of Pension Scheme II are opting for be members of the Widows'/ Widowers' and Orphans Pension Scheme. The Bank does not contribute to the Fund while Bank's employees monthly contribute 5% of their basic salary, to the Fund.

2.5.6.2 Gratuity

With the establishment of Staff Pension Scheme II, employees who joined the Bank on or after 1 October 1995 become members of the Pension Scheme II, thus they are not entitle to the rights and privileges under Service Gratuity Scheme. However, a minimum period of 120 months uninterrupted active service in the Bank at the time of retirement is required to be eligible for any retirement benefit under this pension scheme. Therefore, employees who retire before 10 years of service and whose services are terminated after five years other than by retirement are eligible to receive a terminal gratuity under the Payment of Gratuity Act No. 12 of 1983, at the rate of one half of the gross salary applicable to the last month of the financial year, for each year of continuous service.

Probability of occurrence of such event is rare according to Management's judgement and past experiences. A gratuity provision is not maintained in the Financial Statements unless a significant liability is estimated at reporting date. Where a gratuity is paid to an employee in such event under Payment of Gratuity Act No. 12 of 1983, it is recognised as a gratuity expense in the Income Statement in the same year.

2.5.6.3 Post-employment medical benefits

The Bank has a contributory medical assistance scheme for the retired employees. The assets of the plan are held independently of the Bank's assets and administered by Boards of Trustees, representing the Management and the employees, as provided in the trust deed of the fund.

The Bank contributes to the contributory medical scheme an amount determined by the Management of the Bank based on actuarial recommendation made from time to time. Accordingly, a sum of Rs. 135.6 Mn. has been provided from the profit of 2018.

Details of post-employment medical benefits are given in Note 36. (a) 3 on page 327.

2.5.6.4 Defined contribution plans

Details of defined contribution plans are given in Note 11 on page 284.

2.5.7 Other liabilities

Details of other liabilities are given in Note 39 on page 331.

2.5.8 Provisions

Provisions are recognised when the Group 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 expenses relating to any provision is presented in the Income Statement net of any reimbursement.

2.5.8.1 Provision for fraudulent withdrawals

The total value of fraudulent withdrawals identified as at 31 December 2018 was Rs. 110.3 Mn. A provision of Rs. 81.3 Mn. already exists in the account.

2.5.9 Contingent liabilities and commitments

This includes Bank Guarantees, Letter of Credit, undrawn credit facilities, other indirect credit facilities and capital commitment. The Bank guarantees are contracts that require the Group to make specified payments to reimburse the holder for a loss that it incurs because a specified debtor fails to make payment when it is due in accordance with the terms of a debt instrument. Undrawn loan commitments and Letters of Credits are commitments under which, over the duration of the commitment, the Bank is required to provide a loan with pre-specified terms to the customer.

Effective from 1 January 2018, these contracts are subject to the assessment of impairment under SLFRS 9.

Details of contingent liabilities and commitments are given in Note 46 on page 336.

2.5.10 Earnings per share (EPS)

Details of "Basic and Diluted EPS" are given in Note 14 on page 288.

2.6 Significant accounting policies – Recognition of income and expenses for financial instruments

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. Details of "Income and expenses" are given in Notes 3 to 14 on pages 277 to 288.

2.6.1 Interest and similar income and expense

Details of "Interest income and expenses" are given in Note 3 to 4 on page 277 to 279.

2.6.2 Fee and commission income

Details of "Commission income and expenses" are given in Note 5 on page 279.

2.6.3 Net trading income

Details of "Net gains/(losses) from trading" are given in Note 6 on page 281.

2.6.4 Dividend income

Dividend income is recognised when the right to receive income is established. Usually, this is the ex-dividend date for quoted equity securities. Details of "Dividend income" is given in Note 9 on page 282.

2.6.5 Rent income

Rent income is recognised in profit or loss on an accrual basis. Details of "Rent income" is given in Note 9 on page 282.

2.7 Significant accounting policies – taxation

2.7.1 Current taxation

Details of current taxation are given in Note 13 on page 286.

2.7.2 Deferred taxation

Details of deferred taxation are given in Notes 13 and 29 on page 286 and 317 respectively.

2.7.3 Value added tax (VAT) on financial services

VAT on financial services is calculated in accordance with section 25A of Value Added Tax Act No. 14 of 2002 and subsequent amendments thereto.

VAT on financial services is payable at 15% on operating profit before value added tax and nation building tax on financial services adjusted for emoluments of employees and economic depreciation.

2.7.4 Nation building tax (NBT) on financial services

NBT on financial services is calculated in accordance with Nation Building Tax (Amendment) Act No. 10 of 2014. NBT on financial services is payable at 2% on same base subjected to value added tax on financial services.

2.7.5 Debt repayment levy (DRL) on financial services

The new Finance Act No. 35 of 2018 has imposed a new tax termed the "Debt Repayment Levy" (DRL) which is a temporary levy (From 1 October to 31 December 2021) charged on banks and financial institutions as indicated in the Budget 2018. DRL on financial services is payable at 7% on same base subjected to value added tax on financial services.

2.7.6 Economic service charge (ESC)

Economic Service Charge (ESC) has been administered since 1 April 2006 under the Economic Service Charge (ESC) Act No. 13 of 2006, as amendments thereafter. Prior to this, it has been administered under Finance Acts 11 of 2004 and 11 of 2005 from 1 April 2004 up to 1 April 2006. The rate applicable is 0.25% on relevant turnover. Unclaimed ESC, if any, can be carried forward and set-off against the income tax payable in the five subsequent years. As per budget proposal 2017, the applicable rate is increased to 0.50% on relevant turnover and claimable period limited to three years including existing year effective from 1 January 2017.

As per the provisions of the Finance Act No. 11 of 2004, and amendments thereto, the ESC was introduced with effect from 1 April 2004. Currently, the ESC is payable at 0.25% on "Exempt Turnover" and is deductible from the income tax payments. Unclaimed ESC, if any, can be carried forward and set-off against the income tax payable in the five subsequent years.

2.8 Statement of cash flows

The Statement of Cash Flows has been prepared by using the "Direct Method" of preparing cash flows in accordance with the LKAS 7. Cash and cash equivalents comprise short-term, highly liquid investment that is readily convertible to known amounts of cash and are subject to an insignificant risk of changes in value. The cash and cash equivalents include cash in hand, balances with banks, and money at call and short notice. The Statement of Cash Flows is given on page 256.

2.9 Regulatory provisions

2.9.1 Deposit insurance scheme

The Bank calculates the insurance premium on eligible deposit base at the rate of 0.10% which is the applicable statutory rate based on capital adequacy ratio of the Bank. The Bank has remitted the applicable premium within a period of 15 days from the end of each quarter as stipulated by the Direction.

2.9.2 Crop insurance levy (CIL)

As per the provisions of the 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.

2.10 Events after the reporting period

Details of events after reporting date are given in Note 50 on page 342.

2.11 Accounting standards issued but not yet effective as at reporting date

The following SLFRSs have been issued by The Institute of Chartered Accountants of Sri Lanka that have an effective date in the future and have not been applied in preparing these Financial Statements. Those SLFRSs will have an effect on the accounting policies currently adopted by the Bank and the Group and may have an impact on the future Financial Statements.

2.11.1 Sri Lanka Accounting Standard (SLFRS 16) – Leases

This Standard sets out the principles for the recognition, measurement, presentation, and disclosure of leases. The objective is to ensure that lessees and lessors provide relevant information in a manner that faithfully represents those transactions. This information gives a basis for users of financial statements to assess the effect that leases have on the financial position, financial performance, and cash flows of an entity. This Standard supersedes the following Standard and interpretations:

(a) LKAS 17 – Leases;

(b) IFRIC 4 Determining Whether an Arrangement Contains a Lease;

(c) SIC-15 Operating Leases — Incentives; and

(d) SIC-27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease.

An entity shall apply this Standard for annual reporting periods beginning on or after 1 January 2019. The Bank and the Group have no material net impact on the implementation of the above Standard.

3 — Gross income →

Accounting policy

Gross revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. The specific recognition criteria must also be met before revenue recognition is discussed under respective income notes.

	Bank		Group	
For the year ended 31 December	**2018 Rs. '000**	2017 Rs. '000	**2018 Rs. '000**	2017 Rs. '000
Interest income	**110,506,931**	103,578,838	**111,718,948**	104,424,417
Fee and commission income	**1,005,262**	782,776	**1,008,482**	785,077
Net gain/(loss) from trading	**(707,433)**	1,206,408	**(1,062,421)**	1,520,740
Net fair value gains/(losses) from financial instruments at fair value through profit or loss	**–**	–	**–**	–
Net gains/(losses) from derecognition of financial assets	**6,906**	707,491	**6,906**	707,491
Net other operating income	**1,090,412**	1,720,272	**1,088,539**	796,897
Gross income	**111,902,078**	107,995,784	**112,760,454**	108,234,622

4 — Net interest income →

Accounting policy

Recognition of interest income and interest expenses

For all financial instruments measured at amortised cost, interest-bearing financial assets classified as fair value through other comprehensive income and financial instruments measured 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.

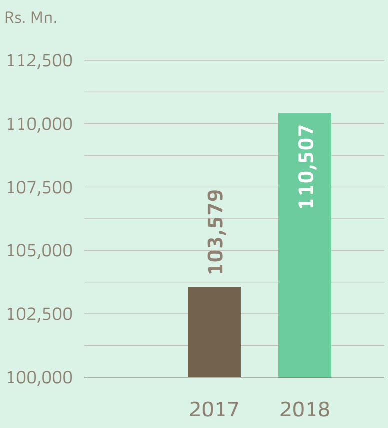
The carrying amount of the financial asset or financial liability is adjusted if the Group revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original EIR and the change in carrying amount is recorded as interest income for financial assets and interest expense for financial liabilities. 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 are 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.

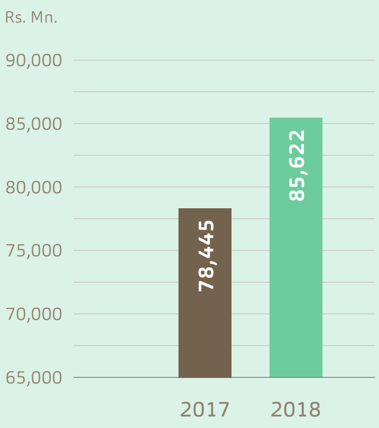
4. Net interest income (contd.)

For the year ended 31 December	Bank 2018 Rs. '000	Bank 2017 Rs. '000	Group 2018 Rs. '000	Group 2017 Rs. '000
4. (a) Interest income				
Cash and cash equivalents	**27,501**	51,967	**27,501**	51,967
Balances with central banks	–	–	–	–
Placements with banks	**1,867,470**	710,462	**1,867,470**	710,462
Derivative financial instruments	–	–	–	–
Financial assets recognised through profit or loss				
– Measured at fair value	**814,915**	1,337,694	**1,489,010**	1,854,041
– Designated at fair value	–	–	–	–
Financial assets at amortised cost				
– Loans and advances	**49,905,753**	42,645,354	**49,866,308**	42,478,728
– Debt and other instruments	**57,733,319**	58,265,141	**58,150,208**	58,603,901
Financial assets measured at fair value through other comprehensive income	**157,972**	568,219	**318,450**	725,318
Total interest income	**110,506,931**	103,578,838	**111,718,948**	104,424,417
4. (b) Interest expenses				
Due to banks	**5,305,589**	2,916,210	**5,544,866**	3,183,899
Financial liabilities recognised through profit or loss	–	–	–	–
Financial liabilities at amortised cost				
– due to depositors	**68,955,361**	60,161,942	**68,955,361**	60,161,942
– due to debt securities holders	–	–	–	–
– due to other borrowers	**927,510**	2,246,794	**1,526,227**	2,521,876
Debt securities issued	**10,433,816**	13,119,880	**10,433,816**	13,119,880
Total interest expenses	**85,622,275**	78,444,825	**86,460,269**	78,987,596
Net interest income	**24,884,656**	25,134,013	**25,258,679**	25,436,821

Interest income



Interest expense



4. Net interest income (contd.)

4. (c) Net interest income from Sri Lanka Government Securities

	Bank		Group	
For the year ended 31 December	**2018 Rs. '000**	2017 Rs. '000	**2018 Rs. '000**	2017 Rs. '000
Interest income	**57,237,192**	58,878,205	**58,460,191**	59,870,757
(Less): Interest expenses	**–**	–	**–**	–
Net interest income from Sri Lanka Government Securities	**57,237,192**	58,878,205	**58,460,191**	59,870,757

4. (d) Notional tax credit for withholding tax on Government Securities on secondary market transactions

In accordance with the Section 137 of the Inland Revenue Act No. 10 of 2006 and amendment thereto, the Group is entitled to a notional tax credit equivalent to 1/9th of the interest income derived from the market transaction in Government Securities up to 31 March 2018. From 1 April 2018 onward, Group is not entitled to get notional tax credit based on the provision of Inland Revenue Act No. 24 of 2017.

Accordingly, the net income earned by the Group from the secondary market transactions up to 31 March 2018 in Government securities, has been grossed up in the Financial Statements and the resulting notional tax credit amounted to Rs. 1,235 Mn. (2017: Rs. 4,787 Mn.) for the Bank and Rs. 1,243.5 Mn. (2017: Rs. 4,815 Mn.) for the Group.

4. (e) Notional tax receivable

The notional tax receivable is given in Note 30 on page 318 to the Financial Statements after deducting the recoverable amounts.

5 Net fee and commission income

Accounting policy

The Group earns fee and commission income from range of services it provides to customers which can be divided into the following two categories.

(a) Fee and commission income earned from services that are provided over a certain period of time:
Fee and commission earned for the provision of services over a period of time are accrued over that period.

(b) Fee and commission income from providing transaction services:

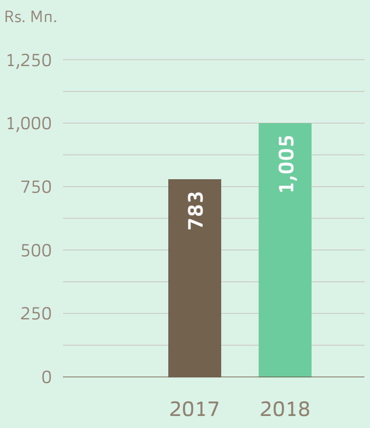
Fee and commission income arising from renegotiating or participating in the negotiation of a transaction for a third party are recognised on completion of the underlying transaction. Fees or components of fees that are linked to a certain performance are recognised as the related services are performed.

Fees and commission expenses relating to transaction and service fees are expensed as the services are received. Fee and commission expenses are recognised on an accrual basis.

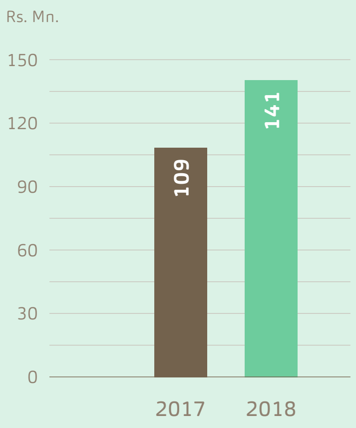
5. Net fee and commission income (contd.)

For the year ended 31 December	Bank 2018 Rs. '000	Bank 2017 Rs. '000	Group 2018 Rs. '000	Group 2017 Rs. '000
Fee and commission income	**1,005,262**	782,776	**1,008,482**	785,077
Fee and commission expenses	**(141,196)**	(109,082)	**(144,685)**	(113,037)
Net fee and commission income	**864,066**	673,694	**863,797**	672,040
Comprising				
Loans	**849,434**	660,273	**849,434**	660,273
Cards	**(53,299)**	(43,413)	**(53,299)**	(43,413)
Trade and remittances	**–**	–	**–**	–
Investment banking	**17,640**	6,644	**17,640**	6,644
Deposits	**24,999**	23,110	**24,999**	23,110
Guarantees	**9,302**	8,465	**9,302**	8,465
Others	**15,990**	18,616	**15,720**	16,961
Net fee and commission income	**864,066**	673,694	**863,797**	672,040

Fee and commission income



Fee and commission expenses



6 — Net gain/(loss) from trading →

Accounting policy

Net trading income includes all gains and losses and related dividend for “financial assets recognised through profit or loss” other than interest income and include income from foreign exchange.

Dividend income is recognised when the Group’s right to receive the payment is established.

For the year ended 31 December	Bank		Group	
	2018 Rs. ’000	2017 Rs. ’000	**2018 Rs. ’000**	2017 Rs. ’000
Foreign exchange				
From banks	–	–	–	–
From other customers	**171,015**	200,639	**171,015**	200,639
Fixed income securities	**(591,815)**	973,468	**(946,802)**	1,287,800
Equity securities	**(309,451)**	334,601	**(309,451)**	334,601
Derivative financial instruments	**22,817**	(302,300)	**22,817**	(302,300)
Total	**(707,433)**	1,206,408	**(1,062,421)**	1,520,740

7 — Net fair value gains/(losses) from financial instruments at fair value through profit or loss →

Accounting policy

Net trading income includes all unrealised gains and losses from changes in fair value of “financial assets and financial liabilities recognised through profit or loss”.

For the year ended 31 December	Bank		Group	
	2018 Rs. ’000	2017 Rs. ’000	**2018 Rs. ’000**	2017 Rs. ’000
Gains on financial assets at fair value through profit or loss	–	–	–	–
Losses on financial assets at fair value through profit or loss	–	–	–	–
Gains on financial liabilities at fair value through profit or loss	–	–	–	–
Losses on financial liabilities at fair value through profit or loss	–	–	–	–
Total	–	–	–	–

8 — Net gains/(losses) from derecognition of financial assets →

Accounting policy

"Net gains/(losses) from financial investments" comprise gains less losses related to financial assets measured at fair value through other comprehensive income and derecognised asset at amortised cost.

	Bank		Group	
For the year ended 31 December	**2018 Rs. '000**	2017 Rs. '000	**2018 Rs. '000**	2017 Rs. '000
Recognised at:				
Fair value through profit or loss	–	–	–	–
Amortised cost	–	–	–	–
Fair value through other comprehensive income	**6,906**	707,491	**6,906**	707,491
Total	**6,906**	707,491	**6,906**	707,491

9 — Net other operating income →

Accounting policy

i. Gain/(Loss) on disposal of property, plant and equipment

The gains or losses on the disposal of property, plant and equipment is determined on the difference between the carrying amount of the assets at the time of disposal and the proceeds of disposal, net of disposal costs. This is recognised in other operating income in the year in which significant risks and rewards of ownership are transferred to the buyer.

ii. Foreign Exchange gain/(loss)

Foreign currency positions are revalued at each reporting date. Gains and losses arising from changes in exchange rates are included in Income Statement in the period in which they arise.

iii. Dividend income

Dividend earned from financial assets measured at fair value through other comprehensive income is recognised when the Group's right to receive the payment is established.

	Bank		Group	
For the year ended 31 December	**2018 Rs. '000**	2017 Rs. '000	**2018 Rs. '000**	2017 Rs. '000
Gain/(Loss) on investment properties	–	–	–	–
Gain/(Loss) on sale of property, plant and equipment	**(25,884)**	2,826	**(25,884)**	2,824
Gain/(Loss) on revaluation of foreign exchange	**843,326**	111,687	**843,326**	111,687
Recovery of loans written off	–	–	–	–
Less: Loans written off	–	–	–	–
Dividend income	**162,601**	1,086,057	**162,601**	163,743
Rent income	**15,738**	15,643	**13,864**	13,769
Other income	**94,631**	504,059	**94,632**	504,874
Total	**1,090,412**	1,720,272	**1,088,539**	796,897

10 — Impairment charges

Accounting policy

The Group recognise the changes in the impairment provisions for all financial instruments, which are assessed as per Sri Lanka Financial Reporting Standard – SLFRS 9 on "Financial Instruments". The measurement of impairment losses both under SLFRS 9 and LKAS 39 across all categories of financial assets requires judgement, in particular, the estimation of the amount and timing of future cash flows and collateral values when determining impairment losses and the assessment of a significant increase in credit risk. These estimates are driven by a number of factors, changes in which can result in different levels of allowances. The Bank's ECL calculations are outputs of complex models with a number of underlying assumptions regarding the choice of variable inputs and their interdependencies. The methodology adopted for impairment is explained in Note 21 (d) to the Financial Statements.

	Bank		Group	
For the year ended 31 December	**2018 Rs. '000**	2017 Rs. '000	**2018 Rs. '000**	2017 Rs. '000
Impairment charge	**851,462**	639,183	**851,407**	639,194
Write-off/waive off	**19,587**	126,664	**19,587**	126,664
Total impairment charges	**871,049**	765,847	**870,994**	765,858
Impairment charges				
Cash and cash equivalents				
Stage 1	**130**	(28)	**130**	(28)
Placement with banks				
Stage 1	**2,191**	469	**2,191**	469
Financial assets at amortised cost – loans and advances [Note 21 (d)]				
Stage 1	**483,565**	102,057	**483,565**	102,057
Stage 2	**143,916**	16,730	**143,916**	16,730
Stage 3	**484,055**	510,307	**484,055**	510,307
Financial assets at amortised cost – debt instruments [Note 22 (b)]				
Stage 1	**(262,395)**	9,649	**(262,450)**	9,660
Stage 2	–	–	–	–
Stage 3	–	–	–	–
Financial assets measured at fair value through other comprehensive income [Note 23 (b)]	–	–	–	–
Contingent liabilities and commitments (Note 46)	–	–	–	–
Investment in subsidiaries [Note 24 (a)]	–	–	–	–
Investments in associates and joint ventures (Note 25)	–	–	–	–
Property, plant and equipment (Note 26)	–	–	–	–
Investment properties (Note 27)	–	–	–	–
Total	**851,462**	639,183	**851,407**	639,194

11 — Personnel expenses

Accounting policy

i Defined contribution plans

The Group operates a defined contribution plan. The contribution payable to a defined contribution plan is in proportion to the services rendered to the Group by the employees and is recorded as an expense under "Personnel expenses". Unpaid contributions are recorded as a liability. The Group contributes to the following defined contribution plans:

(a) Employees' Provident Fund

The Bank and employees contribute 12% and 8% respectively of the employee's monthly gross salary (excluding overtime) to the Provident Fund. The Bank's Provident Fund is an approved fund under the Employees' Provident Fund Act. The Bank guarantees 8% p.a. return to the members of the Employees' Provident Fund.

NSB Fund Management Company and its employees contribute 12% and 8% respectively to the Employees Provident Fund (EPF) maintained by Central Bank of Sri Lanka.

(b) Employees' Trust Fund

The Group contributes 3% of the employee's monthly gross salary (excluding overtime) to the Employees' Trust Fund maintained by the Employees Trust Fund Board.

ii Defined benefit plans

Contribution to defined benefit plans are recognised in the Income Statement based on an actuarial valuation carried out separately for each defined benefit plan in accordance with Sri Lanka Accounting Standard LKAS – 19 on "Employee Benefits".

	Bank		Group	
For the year ended 31 December	**2018 Rs. '000**	2017 Rs. '000	**2018 Rs. '000**	2017 Rs. '000
Salary and bonus	**7,493,963**	5,582,332	**7,525,513**	5,610,084
Contributions to defined contribution/benefit plans	**682,797**	505,189	**684,250**	506,243
Provision for defined benefit obligations (Note 36)	**826,392**	585,425	**826,743**	585,669
Share based expenses	**–**	–	**–**	–
Others	**259,553**	213,558	**266,043**	216,818
Total	**9,262,705**	6,886,505	**9,302,548**	6,918,813

11. (a) Contribution – Staff pension fund – I

	Bank		Group	
For the year ended 31 December	**2018 Rs. '000**	2017 Rs. '000	**2018 Rs. '000**	2017 Rs. '000
Amount recognised as expense	**522,936**	392,077	**522,936**	392,077

Actuarial valuation was carried out by Mr Piyal S Goonetilleke, Fellow of Society of Actuaries (USA) of Piyal S Goonetilleke and Associates, on 31 December 2018 (refer Note 36 (a) 1 on page 323).

11. Personnel expenses (contd.)

11. (b) Contribution – Staff pension fund – II

For the year ended 31 December	Bank		Group	
	2018 Rs. '000	2017 Rs. '000	**2018 Rs. '000**	2017 Rs. '000
Amount recognised as expense	**167,786**	97,240	**167,786**	97,240

Pension scheme II has been established for the employees who joined the Bank on or after 1 October 1995. Actuarial valuation was carried out by Mr Piyal S Goonetilleke, Fellow of Society of Actuaries (USA) of Piyal S Goonetilleke and Associates, on 31 December 2018. (Refer Note 36 (a) 2 on page 325)

11. (c) Contribution – Retired staff medical scheme

For the year ended 31 December	Bank		Group	
	2018 Rs. '000	2017 Rs. '000	**2018 Rs. '000**	2017 Rs. '000
Amount recognised as expense	**135,670**	96,108	**135,670**	96,108

Retired staff medical scheme has been established for the employees who joined the Bank on or after 1 October 1995. Actuarial valuation was carried out by Mr Piyal S Goonetilleke, Fellow of Society of Actuaries (USA) of Piyal S Goonetilleke and Associates, on 31 December 2018. (Refer Note 36 (a) 3 on page 327)

11. (d) Contribution – Gratuity

For the year ended 31 December	Bank		Group	
	2018 Rs. '000	2017 Rs. '000	**2018 Rs. '000**	2017 Rs. '000
Amount recognised as expense	–	–	**351**	244

The staff members of the subsidiary company is not entitled for pension scheme and hence they are continue to the members of Gratuity plan as per the provision of Gratuity Act No. 12 of 1983. (Refer Note 36 (a) 4 on page 329)

Total provision for defined benefit obligations

For the year ended 31 December	Bank		Group	
	2018 Rs. '000	2017 Rs. '000	**2018 Rs. '000**	2017 Rs. '000
Total provision for defined benefit obligations	**826,392**	585,425	**826,743**	585,669

Notes to the Financial Statements

12 — Other expenses

Accounting policy

Other operating expenses are recognised in the Statement of Profit or Loss on the basis of a direct association between the cost incurred and the earning of specific items of income. All expenditure incurred in the running of the business and maintaining the property, plant and equipment in a state of efficiency has been charged to the Statement of Profit or Loss in arriving at the profit of the year. Provisions in respect of other expenses are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, 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. Expenses of depreciation and amortisation of property plant and equipment and intangible assets are separated from other expenses and disclosed in the face of income statement.

	Bank		Group	
For the year ended 31 December	**2018 Rs. '000**	2017 Rs. '000	**2018 Rs. '000**	2017 Rs. '000
Directors' emoluments	**1,890**	1,929	**2,895**	3,089
Auditors' remunerations	**4,087**	5,478	**4,677**	5,988
Non-audit fees to auditors	–	–	–	–
Professional and legal expenses	**21,369**	25,126	**21,369**	25,126
Operating lease expenses	–	–	–	–
Special fees paid to Treasury	**320,000**	320,000	**320,000**	320,000
Office administration and establishment expenses	**3,267,647**	2,828,558	**3,272,909**	2,832,989
Others	**579,986**	556,273	**538,931**	495,573
Total	**4,194,979**	3,737,364	**4,160,782**	3,682,765

13 — Tax expenses

Accounting policy

As per Sri Lanka Accounting Standard – LKAS 12 on "Income Taxes", tax expense is the aggregate amount included in determination of profit or loss for the period in respect of current and deferred taxes. Income tax expense is recognised in Income Statement, except to the extent it relates to items recognised directly in Equity or Other Comprehensive Income (OCI).

Current taxation

Current tax assets and liabilities consist of amounts expected to be recovered from or paid to the Commissioner General of Inland Revenue in respect of the current as well as prior years. The tax rates and tax laws used to compute the amount are those that are enacted or subsequently enacted at the reporting date. Accordingly, provision for taxation is made on the basis of the profit for the year as adjusted for taxation purpose in accordance with the provision of the Inland Revenue Act No. 10 of 2006 and the amendment thereto, at the rates specified below.

Deferred taxation

Deferred tax is provided using the liability method on temporary differences at the reporting date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purpose.

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

13. Tax expenses (contd.)

The carrying amount of a deferred tax asset is reviewed at each reporting date and reduced to the extent 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 asset are reassessed at each reporting date and are recognise to the extent that is probable that future taxable profit will allow the deferred tax asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rate that are expected to apply in the year when the assets are realised or the liabilities are settled, based on tax rates and tax laws that have been enacted or subsequently enacted at the reporting date.

	Bank		Group	
For the year ended 31 December	**2018 Rs. '000**	2017 Rs. '000	**2018 Rs. '000**	2017 Rs. '000
Current tax expenses				
Current year	**3,359,383**	4,328,136	**3,362,374**	4,503,829
Prior years' (over)/under provision	**6,430**	–	**6,430**	(310)
Deferred tax expenses				
Effect of change in tax rates	–	–	–	–
Temporary differences [refer Note 13 (b)]	**75,400**	90,883	**75,252**	91,546
Prior years' provision	–	–	–	–
Total	**3,441,213**	4,419,019	**3,444,056**	4,595,065
Effective tax rate (%)	**43.33**	31.50	**43.35**	33.68
Effective tax rate (excluding deferred tax) (%)	**42.38**	30.85	**42.41**	33.00

13. (a) Reconciliation of tax expenses

	Bank		Group	
For the year ended 31 December	**2018 Rs. '000**	2017* Rs. '000	**2018 Rs. '000**	2017* Rs. '000
Profit before tax	**7,941,364**	14,028,719	**7,944,243**	13,645,212
Income tax for the period (Accounting profit @ 28%)	**2,223,582**	3,928,041	**2,224,388**	3,820,659
Adjustment in respect of current income tax of prior periods				
Add: Tax effect of expenses that are not deductible for tax purposes	**1,884,775**	2,854,015	**1,888,211**	2,881,503
(Less): Tax effect of expenses that are deductible for tax purposes	**748,974**	2,453,920	**750,225**	2,198,334
Tax expense for the period	**3,359,383**	4,328,136	**3,362,374**	4,503,829

* Bank did not restate impact on tax expense due to SLFRS 9.

13. (b) The deferred tax (credit)/charge in the Income Statement comprises the following:

	Bank		Group	
For the year ended 31 December	**2018 Rs. '000**	2017 Rs. '000	**2018 Rs. '000**	2017 Rs. '000
Deferred tax assets	–	–	**(148)**	–
Deferred tax liabilities	**75,400**	90,883	**75,400**	91,546
Deferred tax (credit)/charge to Income Statement	**75,400**	90,883	**75,252**	91,546

14 Earnings per share

Accounting policy

The Group presents basic and diluted earnings per share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss for the year attributable to ordinary shareholders of the Bank by the weighted average number of ordinary shares outstanding during the year. Diluted EPS is determined by adjusting the profit or loss attributable to the ordinary shareholders and the weighted average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares, if any.

	Bank		Group	
For the year ended 31 December	**2018 Rs. '000**	2017 Rs. '000	**2018 Rs. '000**	2017 Rs. '000
Net profit attributable to ordinary equity holders	**4,500,151**	9,715,961	**4,500,187**	9,156,396
Net profit attributable to ordinary equity holders adjusted for the effect of dilution	**4,500,151**	9,715,961	**4,500,187**	9,156,396
Weighted average number of ordinary shares for basic earnings per share	**670,000**	620,000	**670,000**	620,000
Effect of dilution	**–**	–	**–**	–
Weighted average number of ordinary shares adjusted for the effect of dilution	**670,000**	620,000	**670,000**	620,000
Basic earnings per ordinary share	**6.72**	15.67	**6.72**	14.77
Diluted earnings per ordinary share	**6.72**	15.67	**6.72**	14.77

14. (a) Weighted average number of ordinary shares for basic and diluted earnings per share

	Outstanding number of shares		Weight average number of shares	
	2018 Rs. '000	2017 Rs. '000	**2018 Rs. '000**	2017 Rs. '000
Number of shares in issue as at 1 January	**670,000**	620,000	**670,000**	620,000
Add: Number of shares issued during the year* (refer Note 41)	**270,000**	50,000	**–**	–
Number of ordinary shares basic and diluted earnings per share	**940,000**	**670,000**	**670,000**	**620,000**

* Bank has issued 270 Mn. ordinary shares on 31 December 2018.

15 — Analysis of financial instruments by measurement basis

Accounting policy

The carrying amounts of financial instruments by category as defined in Sri Lanka Accounting Standard – SLFRS 9 on "Financial Instruments" under headings of the Statement of Financial Position are summarised below:

15. (a) Bank – 2018

	AC Rs. '000	FVPL Rs. '000	FVOCI Rs. '000	Total Rs. '000
Assets				
Cash and cash equivalents	3,434,524	–	–	3,434,524
Balances with central banks	–	–	–	–
Placements with banks	17,588,445	–	–	17,588,445
Derivative financial instruments	–	–	4,740,106	4,740,106
Loans and advances	423,532,145	–	–	423,532,145
Debt instruments	518,947,969	14,801,463	2,433,915	536,183,346
Equity instruments	–	1,878,919	3,750,515	5,629,434
Total financial assets	**963,503,083**	**16,680,382**	**10,924,536**	**991,108,000**

	AC Rs. '000	FVPL Rs. '000	Total Rs. '000
Liabilities			
Due to banks	77,119,146	–	77,119,146
Derivative financial instruments	–	1,533	1,533
Financial liabilities			
– Due to depositors	839,574,411	–	839,574,411
– Due to debt securities holders	–	–	–
– Due to other borrowers	14,804,802	–	14,804,802
Debt securities issued	52,389,133	–	52,389,133
Total financial liabilities	**983,887,492**	**1,533**	**983,889,025**

AC – Financial assets/liabilities measured at amortised cost
FVPL – Financial assets/liabilities measured at fair value through profit or loss
FVOCI – Financial assets measured at fair value through other comprehensive income

15. Analysis of financial instruments by measurement basis (contd.)

15. (b) Bank – 2017

	AC Rs. '000	FVPL Rs. '000	FVOCI Rs. '000	Total Rs. '000
Assets				
Cash and cash equivalents	3,849,530	–	–	3,849,530
Balances with central banks	–	–	–	–
Placements with banks	23,437,274	–	–	23,437,274
Derivative financial instruments	–	650	1,360,064	1,360,714
Loans and advances	375,703,730	–	–	375,703,730
Debt instruments	555,468,618	4,114,978	1,252,878	560,836,474
Equity instruments	–	2,357,336	4,440,951	6,798,287
Total financial assets	958,459,152	6,472,964	7,053,893	971,986,009

	AC Rs. '000	FVPL Rs. '000	Total Rs. '000
Liabilities			
Due to banks	48,596,591	–	48,596,591
Derivative financial instruments	–	956,937	956,937
Financial liabilities			
– Due to depositors	737,212,640	–	737,212,640
– Due to debt securities holders	–	–	–
– Due to other borrowers	12,837,008	–	12,837,008
Debt securities issued	162,709,027	–	162,709,027
Total financial liabilities	961,355,267	956,937	962,312,204

15. (c) Group – 2018

	AC Rs. '000	**FVPL Rs. '000**	**FVOCI Rs. '000**	**Total Rs. '000**
Assets				
Cash and cash equivalents	**3,436,929**	**–**	**–**	**3,436,929**
Balances with central banks	**177**	**–**	**–**	**177**
Placements with banks	**17,588,445**	**–**	**–**	**17,588,445**
Derivative financial instruments	**–**	**–**	**4,740,106**	**4,740,106**
Loans and advances	**423,557,119**	**–**	**–**	**423,557,119**
Debt instruments	**522,973,159**	**24,988,614**	**4,037,045**	**551,998,818**
Equity instruments	**–**	**1,878,919**	**3,751,515**	**5,630,434**
Total financial assets	**967,555,829**	**26,867,533**	**12,528,666**	**1,006,952,028**

15. Analysis of financial instruments by measurement basis (contd.)

15. (c) Group – 2018 (contd.)

	AC Rs. '000	FVPL Rs. '000	Total Rs. '000
Liabilities			
Due to banks	**83,615,264**	–	**83,615,264**
Derivative financial instruments	–	**1,533**	**1,533**
Financial liabilities			
– Due to depositors	**839,574,411**	–	**839,574,411**
– Due to debt securities holders	–	–	–
– Due to other borrowers	**21,750,178**	–	**21,750,178**
Debt securities issued	**52,389,133**	–	**52,389,133**
Total financial liabilities	**997,328,986**	**1,533**	**997,330,518**

15. (d) Group – 2017

	AC Rs. '000	FVPL Rs. '000	FVOCI Rs. '000	Total Rs. '000
Assets				
Cash and cash equivalents	3,853,989	–	–	3,853,989
Balances with central banks	94	–	–	94
Placements with banks	23,437,274	–	–	23,437,274
Derivative financial instruments	–	–	1,360,714	1,360,714
Loans and advances	374,416,626	–	–	374,416,626
Debt instruments	559,319,752	7,032,614	3,071,981	569,424,346
Equity instruments	–	2,357,336	4,441,951	6,799,287
Total financial assets	961,027,735	9,389,950	8,874,646	979,292,330

	AC Rs. '000	FVPL Rs. '000	Total Rs. '000
Liabilities			
Due to banks	49,352,574	–	49,352,574
Derivative financial instruments	–	956,937	956,937
Financial liabilities			
– Due to depositors	737,212,640	–	737,212,640
– Due to debt securities holders	–	–	–
– Due to other borrowers	17,545,212	–	17,545,212
Debt securities issued	162,709,027	–	162,709,027
Total financial liabilities	966,819,453	956,937	967,776,390

Notes to the Financial Statements

16 — Cash and cash equivalents →

Accounting policy

Cash and cash equivalents includes cash in hand, balances with banks, money at call and short notice that are subject to an insignificant risk of change in their value. Cash and cash equivalents are carried at amortised cost less impairment in the Statement of Financial Position. Balances with banks, and money at call and short notice are subject to the impairment as per SLFRS 9 – "Financial Instrument".

	Bank		Group	
As at 31 December	**2018 Rs. '000**	2017 Rs. '000	**2018 Rs. '000**	2017 Rs. '000
Cash in hand	**699,401**	944,759	**699,411**	944,769
Balances with banks	**2,735,350**	2,892,643	**2,737,745**	2,897,093
Money at call and short notice	–	12,224	–	12,224
Gross total	**3,434,750**	3,849,627	**3,437,155**	3,854,086
Less: Impairment	**(227)**	(97)	**(227)**	(97)
Net Total	**3,434,524**	3,849,530	**3,436,929**	3,853,989

17 — Balances with central banks →

	Bank		Group	
As at 31 December	**2018 Rs. '000**	2017 Rs. '000	**2018 Rs. '000**	2017 Rs. '000
Statutory balances with central banks				
Central Bank of Sri Lanka	–	–	**177**	94
Total	–	–	**177**	94

18 — Placements with banks →

Accounting policy

Placement with banks include short-term deposits placed in banks that are subjected to insignificant risk of changes in fair value, and are used by the Bank and the Group in the management of its short-term commitments. They are recorded in the Financial Statements at their face values or the gross values less impairment, where appropriate. The Group has calculated impairment provision as per SLFRS 9 – "Financial Instrument" based on external rating of particular bank.

18. Placements with banks (contd.)

As at 31 December	Bank 2018 Rs. '000	Bank 2017 Rs. '000	Group 2018 Rs. '000	Group 2017 Rs. '000
Placements with banks – Sri Lanka				
Bank of Ceylon	**4,968,528**	13,607,749	**4,968,528**	13,607,749
People's Bank	–	27,509	–	27,509
Commercial bank	**294,392**	4,409,474	**294,392**	4,409,474
National Development Bank	**2,606,216**	3,578,552	**2,606,216**	3,578,552
Seylan Bank	**8,683,222**	1,724,471	**8,683,222**	1,724,471
Development Finance Corporation of Ceylon (DFCC)	**633,275**	90,350	**633,275**	90,350
Union Bank of Colombo	**405,834**	–	**405,834**	–
Gross total	**17,591,466**	23,438,104	**17,591,466**	23,438,104
Less: Impairment	**(3,021)**	(830)	**(3,021)**	(830)
Net total	**17,588,445**	23,437,274	**17,588,445**	23,437,274

19 — Derivative financial instruments

Accounting policy

Derivatives are financial instruments that derive their value in response to changes in interest rates, financial instrument prices, commodity prices, foreign exchange rates, credit risk and indices. Derivatives are categorised as "trading" unless they are designated as hedging instruments. The Group uses derivatives such as interest rate swaps and forward foreign exchange contracts.

Derivatives recorded at fair value through profit or loss

Derivatives except for derivatives used as hedging instruments are recorded at fair value and carried as assets when their fair value is positive and as liabilities when their fair value is negative. Changes in the fair value of derivatives are included in "Net trading income".

Derivatives used as hedge instruments

The Group entered into derivative contacts to hedge against the foreign exchange rate or interest rate. These derivatives are measured at fair value. The Group adopts hedge accounting mismatch to eliminate the accounting resulting from volatility in the Financial Statements between derivatives measured at fair value and the financial asset or liability (hedge exposure) measured at cost/amortised cost, if hedge is efficient.

Cash flow hedge

Cash flow hedge is measured at fair value at the end of each reporting period.

If a hedge of the exposure to variability in cash flow, the effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in Other Comprehensive Income within "cash flow hedge" – fair value gain/(loss). Any gain or losses in fair value relating to an ineffective portion is recognised immediately in the Income Statements.

The accumulated gains and losses recognised in Other Comprehensive Income are reclassified to the Income Statement in the periods in which the hedged item will affect profit or loss. However, when the forecast transaction that is hedged result in the recognised of a non-financial assets or a non-financial liability, the gains and losses previously recognised in Other Comprehensive Income are removed from equity and included in the initial measurement of the cost of the asset or liability.

When a hedging instrument expires or is sold, or when a hedge no longer meet the criteria for hedge accounting, any cumulative gain or loss recognised in Other Comprehensive Income at that time remains in equity until the forecast transaction is eventually recognised in the Income Statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was recognised in Other Comprehensive Income is immediately reclassified to the Income Statement.

19. Derivative financial instruments (contd.)

19.1 Derivative assets

Bank and Group

As at 31 December	Assets 2018 Rs. '000	Notional amount – 2018 Rs. '000	Assets 2017 Rs. '000	Notional amount – 2017 Rs. '000
Interest rate derivatives				
Foreign currency derivatives				
Currency swaps [Note 19. 2 (b)]	**4,740,106**	**45,551,031**	1,360,064	28,106,213
Forward foreign exchange contracts	–	–	650	306,400
Total	**4,740,106**	**45,551,031**	1,360,714	28,412,613

19.2 Foreign Currency SWAPs

The Bank has raised USD 750 Mn. on 18 September 2013 through foreign borrowings for a period of five years against which two Swaps agreements have been entered into with the Central Bank of Sri Lanka for USD 183.425 Mn. and USD 187.5 Mn. with annual and monthly renewal basis respectively.

The Bank has also raised USD 250 Mn. on 10 September 2014 through foreign borrowings for a period of five years against which a Swap agreement has been entered into with the Central Bank of Sri Lanka for USD 249.31 Mn. with monthly renewal basis.

The objective of the Swaps is to hedge the risk of the foreign currency denominated above mentioned borrowings (only the capital portion) attributable to changes in LKR/USD exchange rate.

A brief description of the Swaps is given below:

19.2 (a) Swap agreements 1

Details	Description of the hedge	
Hedge instrument	**Swap contract – 1**	USD 183.425 Mn. agreement was expired on 12 September 2018
Hedge Item		5 years USD denominated Senior Note – USD 750 Mn. with interest payable semi annually Capital is fully paid on 18 September 2018.
The period when the cash flows are expected to occur	**Swap contract – 1**	Expired
The amount recognised in Other Comprehensive Income during the year	**Swap contract – 1**	Expired
	Swap contract – 1	Rs. 291.924 Mn. debited to the cash flow hedge reserve
Fair value of hedged item as at 31 December 2018		Nil
Fair value of hedged instrument as at 31 December 2018	**Swap contract – 1**	Nil
Any forecast transaction for which hedge accounting had previously been used but which is no longer expected to occur		None
The amount that was reclassified from equity to profit or loss during the year		None

19. Derivative financial instruments (contd.)

19.2 (b) Swap agreements 3

Details	Description of the hedge	
Hedge instrument	**Swap Contract**	Counter party – Central Bank of Sri Lanka Notional amount – USD 249.31 Mn. 99.72% of the total foreign borrowings. The Bank has renewed the above agreement with Central Bank on 25 January 2018 for a Notional amount of USD 249.31 Mn. at a premium.
Hedge item		5 years USD denominated senior note – USD 250 Mn. with interest payable semi annually. Capital is repayable on 10 September 2019 in full.
The period when the cash flows are expected to occur		Annually
The amount recognised in Other Comprehensive Income during the year		None
Fair value of hedged item as at 31 December 2018		Rs. 45,677.1 Mn.
Fair value of hedged instrument as at 31 December 2018		None
Any forecast transaction for which hedge accounting had previously been used but which is no longer expected to occur		None
The amount that was reclassified from equity to profit or loss during the period		None

19.2 (c) Amount recognised in other comprehensive income relating to the currency swaps

	Bank		Group	
For the year ended 31 December	**2018 Rs. '000**	2017 Rs. '000	**2018 Rs. '000**	2017 Rs. '000
Swap agreement – 01	**(291,924)**	290,074	**(291,924)**	290,074

20 — Financial assets recognised through profit or loss

Accounting policy

Financial assets are classified as financial assets recognised through profit or loss if they are acquired principally for the purpose of selling or repurchasing in the near term or holds as a part of a portfolio that is managed together for short-term profit or position taking and recorded to fair value. This category also includes derivative financial instruments entered into by the Group that are not designated as hedging instruments in hedge relationships. Financial asset shall be measured at fair value through profit or loss unless it is measured at amortised cost or fair value through other comprehensive income as per SLFRS 9 – “Financial Instruments”.

Financial assets financial assets recognised through profit or loss are recorded in the Statement of Financial Position at fair value. Changes in fair value are recognised in “Net gain/(loss) from trading” while interest income and expenses are recorded in “Net interest income” according to the terms of the contract, or when the right to the payment has been established. Dividend income and Realised gain or losses are recorded in “Net Gain/(Loss) from Trading”.

The Group evaluates its financial assets recognised through profit or loss, other than derivatives, to determine whether the intention to sell them in the near term is still appropriate. When the Group is unable to trade these financial assets due to inactive markets and Management’s intention to sell them in the foreseeable future significantly changes, the Group may elect to reclassify these financial assets, in rare circumstances.

	Bank		Group	
As at 31 December	**2018 Rs. ’000**	2017 Rs. ’000	**2018 Rs. ’000**	2017 Rs. ’000
Measured at fair value				
Sri Lanka Government Securities				
Treasury Bills	–	–	**661,361**	499,798
Treasury Bonds	**14,801,463**	4,114,978	**24,327,253**	6,532,816
Equity securities [Note 20 (b)]	**1,878,919**	2,357,336	**1,878,919**	2,357,336
Subtotal	**16,680,382**	6,472,314	**26,867,533**	9,389,950
Designated at fair value	–	–	–	–
Total	**16,680,382**	6,472,314	**26,867,533**	9,389,950

20. (a) Analysis

	Bank		Group	
As at 31 December	**2018 Rs. ’000**	2017 Rs. ’000	**2018 Rs. ’000**	2017 Rs. ’000
By collateralisation				
Pledged as collateral	–	–	**9,595,990**	2,848,477
Unencumbered	**16,680,382**	6,472,314	**17,271,543**	6,541,473
Gross total	**16,680,382**	6,472,314	**26,867,533**	9,389,950
By Currency				
Sri Lankan Rupee	**16,680,382**	6,472,314	**26,867,533**	9,389,950
United States Dollar	–	–	–	–
Gross total	**16,680,382**	6,472,314	**26,867,533**	9,389,950

20. Financial assets recognised through profit or loss (contd.)

20. (b) Equity securities (quoted) – Bank and Group

As at 31 December	2018			2017		
	Number of shares	**Cost Rs. '000**	**Market value Rs. '000**	Number of shares	Cost Rs. '000	Market value Rs. '000
1. Banks, finance and insurance						
Commercial Bank of Ceylon PLC	**991,418**	**139,295**	**114,013**	485,180	76,303	65,245
Commercial Bank of Ceylon PLC (NV)	**273,294**	**33,862**	**25,963**	268,731	33,862	27,901
DFCC Bank	**430,000**	**85,787**	**39,990**	430,000	85,787	52,723
Hatton National Bank PLC (NV)	**287,649**	**49,599**	**48,469**	284,964	49,599	54,946
Lanka ORIX Leasing Co. Holding PLC	**2,860**	**323**	**257**	28,060	3,171	3,191
LOLC Finance PLC	**4,550,000**	**50,340**	**15,470**	4,550,000	50,340	17,096
Sampath Bank PLC	**534,925**	**142,425**	**125,707**	128,723	31,222	40,106
Union Bank PLC	**245,000**	**6,009**	**2,695**	245,000	6,009	3,174
		507,640	**372,564**		336,293	264,382
2. Beverage, food and tobacco						
Cargills (Ceylon) PLC	–	–	–	114,320	21,003	22,608
					21,003	22,608
3. Chemical and pharmaceuticals						
CIC Holdings PLC	**135,839**	**15,558**	**5,379**	135,839	15,558	8,959
CIC Holdings PLC (NV)	**13,700**	**1,183**	**411**	13,700	1,183	704
Haycarb PLC	**447,211**	**83,786**	**58,137**	447,211	83,786	64,341
		100,527	**63,927**		100,527	74,004
4. Construction and engineering						
Access Engineering PLC	**3,470,023**	**132,692**	**48,927**	3,470,023	132,692	80,975
Colombo Dockyard PLC	**1,234,706**	**275,603**	**68,650**	1,234,706	275,603	107,193
		408,295	**117,577**		408,295	188,168
5. Diversified holdings						
Aitken Spence PLC	**2,493,516**	**294,681**	**119,190**	2,593,516	306,499	138,738
Browns Investments PLC	**13,017,669**	**65,088**	**24,734**	14,367,669	71,838	36,938
C T Holdings PLC	**10,133**	**802**	**1,728**	74,585	13,073	13,282
Hayleys PLC	**123,026**	**41,512**	**23,006**	123,026	41,512	29,196
Hemas Holdings PLC	**650,000**	**69,656**	**57,720**	–	–	–
John Keells Holdings PLC	**1,039,610**	**174,244**	**166,026**	2,660,190	465,818	391,140
Richard Pieris & Company PLC	**6,463,907**	**60,911**	**67,871**	6,463,907	60,911	82,450
Vallibel One PLC	**3,269,832**	**75,511**	**55,587**	3,143,693	72,975	55,020
		782,405	**515,862**		1,032,626	746,764

20. Financial assets recognised through profit or loss (contd.)

20. (b) Equity securities (quoted) – Bank and Group (contd.)

As at 31 December	2018			2017		
	Number of shares	**Cost Rs. '000**	**Market value Rs. '000**	Number of shares	Cost Rs. '000	Market value Rs. '000
6. Hotels and travels						
Asian Hotels & Properties PLC	**1,366,132**	**106,609**	**58,607**	1,366,132	106,609	71,324
Aitken Spence Hotel Holdings PLC	**2,102,133**	**188,903**	**56,759**	2,102,133	188,903	61,110
Ceylon Hotels Corporation PLC	**3,975,017**	**128,776**	**47,700**	3,975,017	128,776	62,888
John Keells Hotels PLC	**5,541,205**	**103,475**	**43,221**	5,541,205	103,475	48,216
Lighthouse Hotels PLC	**1,175,667**	**71,492**	**34,330**	1,175,667	71,492	52,080
Mahaweli Reach Hotels PLC	**133,300**	**4,884**	**1,733**	133,300	4,884	2,373
Marawila Resorts PLC	**699,556**	**5,915**	**1,259**	1,900	16,063	3,569
The Kingsbury PLC	**2,871,666**	**65,038**	**43,649**	4,669,876	105,764	62,337
Jetwing Symphony Limited	**1,300,000**	**19,500**	**15,600**	1,300,000	19,500	19,500
		694,592	**302,858**		745,466	383,397
7. Investment trusts						
Renuka Holdings PLC (NV)	**466,438**	**11,307**	**6,857**	466,438	11,307	8,302
		11,307	**6,857**		11,307	8,302
8. Land and property						
Overseas Reality (Ceylon) PLC	**943,473**	**23,777**	**15,567**	943,473	23,777	16,419
		23,777	**15,567**		23,777	16,419
9. Manufacturing						
Teejay Lanka PLC	**425,429**	**14,110**	**13,826**	40,095	1,480	1,348
Lanka Ceramic PLC	**89,191**	**12,069**	**11,675**	89,191	12,069	13,229
Royal Ceramics Lanka PLC	**1,748,679**	**221,888**	**130,452**	1,748,679	221,888	197,981
Tokyo Cement Company (Lanka) PLC	**688,992**	**29,030**	**17,363**	688,992	29,029	44,964
Tokyo Cement Company (Lanka) PLC (NV)	**611,060**	**22,602**	**14,054**	611,060	22,602	35,649
Alumex PLC	**121,295**	**2,074**	**1,637**	16,150	277	294
		301,773	**189,007**		287,345	293,465
10. Power and energy						
Resus Energy PLC	–	–	–	203,341	4,653	3,639
LVL Energy Fund PLC	**4,606,600**	**46,066**	**38,695**	4,606,600	46,066	46,066
		46,066	**38,695**		50,719	49,705

20. Financial assets recognised through profit or loss (contd.)

20. (b) Equity securities (quoted) – Bank and Group (contd.)

As at 31 December	2018			2017		
	Number of shares	**Cost Rs. '000**	**Market value Rs. '000**	Number of shares	Cost Rs. '000	Market value Rs. '000
11. Telecommunication						
Dialog Axiata PLC	**3,738,360**	**81,332**	**37,757**	3,790,960	94,332	49,105
		81,332	**37,757**		94,332	49,105
12. Trading						
Browns & Company PLC	**985,000**	**315,149**	**60,085**	985,000	315,149	77,820
		315,149	**60,085**		315,149	77,820
13. Unit trust						
Comtrust Equity Fund	**556,793**	**10,000**	**9,869**	556,793	10,000	11,139
Ceybank Unit Trust	**7,604,797**	**85,110**	**148,294**	7,604,797	85,110	172,058
		95,110	**158,163**		95,110	183,197
Total		**3,367,973**	**1,878,919**		3,521,949	2,357,336

21 — Financial assets at amortised cost – loans and advances

Accounting policy

Loans and receivables to banks include non derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than:

- Those that the Group intends to sell immediately or in the near term and those that the Group, upon initial recognition, designates as at fair value through profit or loss
- Those that the Group, upon initial recognition, designates financial assets measured at fair value through other comprehensive income
- Those for which the Group may not recover substantially all of its initial investment, other than due to credit deterioration

"Loans and receivables to banks" include amounts due from banks. After initial measurement, loans and receivables 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 Income Statement. The losses arising from impairment are recognised in "impairment charge for loans and other losses" in the Income Statement.

From 1 January 2018, the Bank only measures loans and advances at amortised cost if both of the following conditions are met:

- The financial asset is held within a business model with the objective to hold financial assets in order to collect contractual cash flows
- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest (SPPI) on the principal amount outstanding

Details of business model & SPPI test are given in Notes 2.5.1.4.1 and 2.5.1.4.2 on page 264.

21. Financial assets at amortised cost – loans and advances (contd.)

As at 31 December	Bank 2018 Rs. '000	Bank 2017 Rs. '000	Group 2018 Rs. '000	Group 2017 Rs. '000
Gross loans and advances				
Non-credit impaired	**28,819,417**	28,589,141	**28,844,390**	27,302,037
Stage 1	**385,683,843**	340,653,973	**385,683,843**	340,653,973
Stage 2	**6,470,038**	3,988,238	**6,470,038**	3,988,238
Stage 3	**6,405,157**	5,207,152	**6,405,157**	5,207,152
Gross loan and advances	**427,378,455**	378,438,504	**427,403,428**	377,151,400
(Less): Accumulated impairment under:				
Stage 1	**1,610,731**	1,127,166	**1,610,731**	1,127,166
Stage 2	**272,348**	128,432	**272,348**	128,432
Stage 3	**1,963,230**	1,479,175	**1,963,230**	1,479,175
Total Impairment	**3,846,309**	2,734,773	**3,846,309**	2,734,773
Net loans and advances	**423,532,145**	375,703,730	**423,557,119**	374,416,626

21. (a) Analysis by product

As at 31 December	Bank 2018 Rs. '000	Bank 2017 Rs. '000	Group 2018 Rs. '000	Group 2017 Rs. '000
By product				
Trade finance	–	–	–	–
Central Bank Treasury Bills	–	–	–	–
Lease rental and receivable	–	–	–	–
Pawning	**30,530,726**	23,874,051	**30,530,726**	23,874,051
Staff loans	**6,103,442**	5,057,767	**6,103,442**	5,057,767
Term loans				
Short term	**6,080,407**	1,458,560	**6,080,407**	1,458,560
Long term	**380,231,640**	340,380,153	**380,231,640**	340,380,153
Others				
Sri Lanka Government Securities	–	–	–	–
Loan to Government	**2,075,000**	2,075,000	**2,075,000**	2,075,000
Securities purchased under resale agreements	**2,357,240**	5,592,973	**2,382,213**	4,305,869
Gross total	**427,378,455**	378,438,504	**427,403,428**	377,151,400

21. Financial assets at amortised cost – loans and advances (contd.)

21. (b) Analysis by currency

As at 31 December	Bank		Group	
	2018 Rs. '000	2017 Rs. '000	**2018 Rs. '000**	2017 Rs. '000
By currency				
Sri Lankan Rupee	**408,075,240**	350,356,753	**408,100,213**	349,069,649
United States Dollar	**19,303,215**	28,081,751	**19,303,215**	28,081,751
Gross total	**427,378,455**	378,438,504	**427,403,428**	377,151,400

21. (c) Analysis by sector

As at 31 December	Bank		Group	
	2018 Rs. '000	2017 Rs. '000	**2018 Rs. '000**	2017 Rs. '000
By industry				
Agriculture and fishing	**20,817,480**	14,990,754	**20,817,480**	14,990,754
Manufacturing	–	–	–	–
Tourism	**38,746**	49,042	**38,746**	49,042
Transport	**1,356,593**	1,040,305	**1,356,593**	1,040,305
Construction/housing	**116,223,402**	107,478,175	**116,223,402**	107,478,175
Traders	–	–	–	–
New economy	–	–	–	–
Others				
Financial and business services	**26,413,837**	27,452,914	**26,413,837**	27,452,914
Infrastructure	**76,286,787**	76,080,169	**76,286,787**	76,080,169
Power and energy	**6,801,197**	8,525,567	**6,801,197**	8,525,567
Education	**36,362,632**	31,844,099	**36,362,632**	31,844,099
Personal/pawning/other	**143,077,781**	110,977,478	**143,102,754**	109,690,374
Gross total	**427,378,455**	378,438,504	**427,403,428**	377,151,400

21. (d) Movements in impairment during the year

Accounting policy

Individual assessment of impairment

For financial assets carried at amortised cost (such as amounts due from banks, loans and advances to customers as well as financial assets at amortised cost – debt and other instruments), the Group 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 Group 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.

21. Financial assets at amortised cost – loans and advances (contd.)

21. (d) Movements in impairment during the year (contd.)

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 a provision account and the amount of the loss is recognised in the Income Statement. Interest income continues to be accrued on the reduced carrying amount at 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".

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 Group has reclassified trading assets to loans and receivables, 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.

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 Group. If, in a subsequent year, the amount of the estimated impairment loss increased or decreased 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 "Credit loss expense".

Collective Assessment of Impairment

If the Group 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.

Future cash flows on a group of financial assets that are collectively evaluated for impairment are estimated on the basis of expected loss experience for assets with credit risk characteristics similar to those in the Group. Expected loss experience is adjusted on the basis of current observable date to reflect the effect of current conditions on which the historical loss experience is based and to remove the effect 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.

Write-off of loans and receivables

The Bank's accounting policy under SLFRS 9 remains the same as it was under LKAS 39. Loans (and the related impairment allowance accounts) are normally written off, either partially or in entirety, when there is no realistic prospect of recovery and all possible steps have been exhausted in recovering dues. Where loans are secured, this is generally after receipt of any proceeds from the realisation of security. If the amount to be written off is greater than the accumulated loss allowance, the difference is first treated as an addition to the allowance that is then applied against the gross carrying amount. If a write-off is later recovered, the recovery is credited to "other operating income".

21. Financial assets at amortised cost – loans and advances (contd.)

21. (d) Movements in impairment during the year (contd.)

Collateral Valuation

The Group uses collateral where possible to mitigate the risk on financial assets. The collateral comes in various forms such as cash, gold, Government Securities. To the extent possible, the Bank uses active market data for valuing financial assets held as collaterals.

Detail of impairment policy are given in Note 2.5.2 on page 269.

	Bank		Group	
As at 31 December	**2018 Rs. '000**	2017 Rs. '000	**2018 Rs. '000**	2017 Rs. '000
Stage 1				
Balance as at 1 January	**1,127,166**	1,025,110	**1,127,166**	1,025,110
Charge/(Write back) to Income Statement	**483,565**	102,056	**483,565**	102,056
Write-off during the year	–	–	–	–
Other movements	–	–	–	–
Balance as at 31 December	**1,610,731**	1,127,166	**1,610,731**	1,127,166
Stage 2				
Balance as at 1 January	**128,432**	111,702	**128,432**	111,702
Charge/(Write back) to Income Statement	**143,916**	16,730	**143,916**	16,730
Write-off during the year	–	–	–	–
Other movements	–	–	–	–
Balance as at 31 December	**272,348**	128,432	**272,348**	128,432
Stage 3				
Balance as at 1 January	**1,479,175**	968,868	**1,479,175**	968,868
Charge/(Write back) to Income Statement	**503,642**	636,971	**503,642**	636,971
Write-off during the year	**(19,587)**	(126,664)	**(19,587)**	(126,664)
Other movements	–	–	–	–
Balance as at 31 December	**1,963,230**	1,479,175	**1,963,230**	1,479,175

21. (e) Lease rentals receivable

No items to be disclosed under lease rental receivable.

22 — Financial assets at amortised cost – debt and other instruments

Accounting policy

Financial assets at amortised cost – debt and other instruments are non-derivative financial assets with fixed or determinable payments and fixed maturities, which the Group has the intention and ability to hold to maturity. After initial measurement, financial assets at amortised cost – debt and other instruments 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 charges".

As at 31 December	Bank		Group	
	2018 Rs. '000	2017 Rs. '000	**2018 Rs. '000**	2017 Rs. '000
Sri Lanka Government securities				
Treasury Bills	**21,005,363**	35,115,115	**21,005,363**	35,115,115
Treasury Bonds	**484,786,616**	450,001,836	**488,460,612**	453,653,149
Sri Lanka Development Bond (SLDB)	**178,560**	59,156,126	**178,560**	59,156,126
Corporate debt instruments	**7,653,898**	7,813,406	**8,005,137**	8,013,326
Trust certificates	**5,332,605**	3,653,603	**5,332,605**	3,653,603
Gross total	**518,957,041**	555,740,085	**522,982,276**	559,591,319
Less: Impairment	**(9,072)**	(271,467)	**(9,117)**	(271,567)
Net total	**518,947,969**	555,468,618	**522,973,159**	559,319,752

22. (a) Analysis

As at 31 December	Bank		Group	
	2018 Rs. '000	2017 Rs. '000	**2018 Rs. '000**	2017 Rs. '000
By collateralisation				
Pledged as collateral	**69,160,408**	48,382,000	**72,546,833**	51,689,909
Unencumbered	**449,796,633**	507,358,085	**450,435,443**	507,901,410
Gross total	**518,957,041**	555,740,085	**522,982,276**	559,591,319
By currency				
Sri Lankan Rupee	**518,778,481**	496,583,959	**522,803,716**	500,435,193
United States Dollar	**178,560**	59,156,126	**178,560**	59,156,126
Gross total	**518,957,041**	555,740,085	**522,982,276**	559,591,319

22. Financial assets at amortised cost – debt and other instruments (contd.)

22. (b) Movements in impairment during the year

As at 31 December	Bank 2018 Rs. '000	Bank 2017 Rs. '000	Group 2018 Rs. '000	Group 2017 Rs. '000
Stage 1				
Opening balance as at 1 January	**271,467**	261,818	**271,567**	261,907
Charge/(Write back) to Income Statement	**(262,395)**	9,649	**(262,450)**	9,660
Write-off during the year	–	–	–	–
Other movements	–	–	–	–
Closing balance at 31 December	**9,072**	271,467	**9,117**	271,567

No impairment movements for Stages 2 and 3.

23 Financial assets at fair value through other comprehensive income

Accounting policy

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. Debt securities in this category are those which are intended to be held for an indefinite period of time and which may be sold in response to needs for liquidity or in response to changes in the market conditions.

After initial measurement, available-for-sale financial investments are subsequently measured at fair value. Equity investments under AFS that do not have quoted market price and whose fair value cannot be reliably measured shall be measured at cost.

Unrealised gains and losses are recognised directly in equity (Other Comprehensive Income) 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 "Net gain/(loss) from financial investment". Where the Group holds more than one investment in the same security they are deemed to be disposed of on a first-in first-out basis. Interest earned whilst holding available-for-sale financial investments is required as interest income using the EIR. 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".

Impairment of financial assets at fair value through other comprehensive income

For available-for-sale financial investments including debt securities, the Group 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 Group assesses individually whether there is objective evidence of impairment based on the same criteria as financial asset 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 interest income is based 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". If, in a subsequent period, the fair value of a debt instrument increased and the increase can be objectively related to a credit event occurring after the impairment loss was recognised in the Income Statement, the impairment loss is reversed through the Income Statement.

23. Financial assets at fair value through other comprehensive income (contd.)

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. The Group treats "significant" generally as 20% and "prolonged" generally as greater than six months. 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 Other Comprehensive Income 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.

Accounting policy (applicable after 1 January 2018)

Financial Assets at Fair Value through Other Comprehensive Income include equity and debt securities. Equity investments classified as Fair Value through Other Comprehensive Income are those which are hold as strategic investment. Debt securities in this category are those which are intended to be held for an indefinite period of time and which may be sold in response to needs for liquidity or in response to changes in the market conditions.

After initial measurement, Financial Assets at Fair Value through Other Comprehensive Income are subsequently measured at fair value. Financial Assets at Fair Value through Other Comprehensive Income can be divided into two category as follows:

i. Equity instruments fair value through other comprehensive income

Upon initial recognition, the Bank occasionally elects to classify irrevocably some of its equity investments as equity instruments at FVOCI when they meet the definition of definition of Equity under LKAS 32 Financial Instruments: Presentation and are not held for trading. Such classification is determined on an instrument-by instrument basis.

"Unrealized gains and losses are recognised directly in equity (Other Comprehensive Income) in the "OCI reserve". Gains and losses on these equity instruments are never recycled to profit. Dividends are recognised in profit or loss as other operating income when the right of the payment has been established, except when the Bank benefits from such proceeds as a recovery of part of the cost of the instrument, in which case, such gains are recorded in OCI. Equity instruments at FVOCI are not subject to an impairment assessment".

Equity investments under FVOCI that do not have quoted market price and whose fair value cannot be reliably measured shall be measured at cost.

ii. Debt instruments at fair value through other comprehensive income

The Bank applies the new category under SLFRS 9 of debt instruments measured at FVOCI when both of the following conditions are met:

- The instrument is held within a business model, the objective of which is achieved by both collecting contractual cash flows and selling financial assets
- The contractual terms of the financial asset meet the SPPI test

These instruments largely comprise assets that had previously been classified as financial investments available for sale under LKAS 39.

23. Financial assets at fair value through other comprehensive income (contd.)

Interest earned whilst holding financial asset at Fair Value through Other Comprehensive Income is recognised as interest income using the EIR. The losses arising from impairment of such investments are recognised in the Income Statement in “Impairment charges”.

As at 31 December	Bank 2018 Rs. '000	Bank 2017 Rs. '000	Group 2018 Rs. '000	Group 2017 Rs. '000
Sri Lanka Government securities				
Treasury Bills [Note 23 (c)]	–	1,171,488	–	1,171,488
Treasury Bonds [Note 23 (d)]	**2,433,915**	81,390	**4,037,045**	1,900,493
Equity securities				
Quoted equity securities [Note 23 (e)]	**3,447,888**	3,876,570	**3,447,888**	3,876,570
Unquoted equity securities [Note 23 (f)]	**302,627**	564,381	**303,627**	565,381
Corporate debt instruments	–	–	–	–
(Less): Impairment	–	–	–	–
Net financial assets at fair value through other comprehensive income	**6,184,430**	5,693,829	**7,788,560**	7,513,932

23. (a) Analysis

As at 31 December	Bank 2018 Rs. '000	Bank 2017 Rs. '000	Group 2018 Rs. '000	Group 2017 Rs. '000
By collateralisation				
Pledged as collateral	–	–	**1,524,097**	1,690,832
Unencumbered	**6,184,430**	5,693,829	**6,264,463**	5,823,100
Gross total	**6,184,430**	5,693,829	**7,788,560**	7,513,932
By Currency				
Sri Lankan Rupee	**6,184,430**	5,693,829	**7,788,560**	7,513,932
United States Dollar	–	–	–	–
Gross total	**6,184,430**	5,693,829	**7,788,560**	7,513,932

23. (b) Movements in impairment during the year

No impairment movement during the year.

23. Financial assets at fair value through other comprehensive income (contd.)

23. (c) Sri Lanka Government Securities – Treasury Bills

	2018 – Bank and Group			2017 – Bank and Group		
	Face value Rs. '000	Cost of investment Rs. '000	Fair value Rs. '000	Face value Rs. '000	Cost of investment Rs. '000	Fair value Rs. '000
Sri Lanka Government Securities – Treasury Bills	–	–	–	1,200,000	1,164,059	1,171,488
					1,164,059	1,171,488

23. (d) Sri Lanka Government Securities – Treasury Bonds

	2018 – Bank			2017 – Bank		
	Face value Rs. '000	Cost of investment Rs. '000	Fair value Rs. '000	Face value Rs. '000	Cost of investment Rs. '000	Fair value Rs. '000
Sri Lanka Government Securities – Treasury Bonds	2,426,000	2,454,815	2,433,915	76,000	74,709	81,390
		2,454,815	2,433,915		74,709	81,390

	2018 – Group			2017 – Group		
	Face value Rs. '000	Cost of investment Rs. '000	Fair value Rs. '000	Face value Rs. '000	Cost of investment Rs. '000	Fair value Rs. '000
Sri Lanka Government Securities – Treasury Bonds	3,951,000	4,267,031	4,037,045	1,751,000	2,037,829	1,900,493
		4,267,031	4,037,045		2,037,829	1,900,493

23. (e) Quoted investments – equity securities – Bank and Group

	2018			2017		
	No. of shares	Cost Rs. '000	Fair value Rs. '000	No. of shares	Cost Rs. '000	Fair value Rs. '000
Hatton National Bank PLC	11,346,652	1,655,816	2,428,184	11,262,707	1,655,816	2,773,004
Sri Lanka Telecom PLC	13,158,700	445,642	307,913	13,158,700	445,642	369,522
People's Leasing Company PLC	43,668,157	784,405	711,791	43,668,157	784,405	734,044
		2,885,863	3,447,888		2,885,863	3,876,570

23. Financial assets at fair value through other comprehensive income (contd.)

23. (f) Unquoted investments – equity securities

	2018 – Bank			2017 – Bank		
	Number of shares	Cost Rs. '000	Cost/fair value Rs. '000	Number of shares	Cost Rs. '000	Cost/fair value Rs. '000
Investment – Credit Information Bureau	**30,450**	**57,364**	**57,364**	30,450	57,364	57,364
Investment – Associated Newspapers Ceylon Limited	**20,000**	**127**	**127**	20,000	127	127
Investment – Regional Development Bank (RDB)	**16,452,126**	**164,521**	**245,136**	16,452,126	164,521	506,890
(Less): Impairment		**–**	**–**		–	–
		222,012	**302,627**		222,012	564,381

	2018 – Group			2017 – Group		
	Number of shares	Cost Rs. '000	Cost/fair value Rs. '000	Number of shares	Cost Rs. '000	Cost/fair value Rs. '000
Investment – Credit Information Bureau	**30,450**	**57,364**	**57,364**	30,450	57,364	57,364
Investment – Associated Newspapers Ceylon Limited	**20,000**	**127**	**127**	20,000	127	127
Investment – Regional Development Bank (RDB)	**16,452,126**	**164,521**	**245,136**	16,452,126	164,521	506,890
Investment – Sri Lankan Financial Services Bureau	**100,000**	**1,000**	**1,000**	100,000	1,000	1,000
(Less): Impairment		**–**	**–**		–	–
		223,012	**303,627**		223,012	565,381

All unquoted equities in financial assets measured at Fair Value through Other Comprehensive Income (except RDB) are recorded at cost, since its fair value can not be reliably estimated. There is no active market for these investments and Bank intends to hold it for the long term. The investment in RDB shares have been fair valued using a valuation model based on observable data.

24 — Investments in subsidiaries

Accounting policy

Investments in subsidiary companies are accounted at cost less allowance for impairment in Financial Statements of the Bank. The net assets of subsidiary company are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the recoverable amount of investment is estimated and the impairment loss is recognised to the extent of its loss in net assets.

As at 31 December	2018	2017	2018		2017	
			Cost*	Directors' valuation**	Cost	Directors' valuation**
	%	%	Rs. '000	Rs. '000	Rs. '000	Rs. '000
Unquoted equity investments						
NSB Fund Management Co. Ltd.	**100**	100	**1,700,000**	**2,722,821**	900,000	1,944,586
(170,000,000 ordinary shares of Rs. 10.00 each.)						
(Less): Impairment			–	–	–	–
Net total			**1,700,000**	**2,722,821**	900,000	1,944,586

* The subsidiary has issued Rs. 800 Mn. worth of shares during the year.

** The Director's valuation of investments in subsidiary has been carried out on net asset basis as at 31 December 2018 based on audited Financial Statements.

24. (a) Movements in impairment during the year

No impairment movements during the year 2018.

25 — Investment in associates and joint ventures

No investment in associates and joint ventures.

26 — Property, plant and equipment

Accounting policy

Basis of recognition

Property, plant and equipment are recognised if it is probable that future benefits associated with the asset will flow to the Group and cost of the asset can be reliably measured. Property, plant and equipment are initially measured at cost including costs directly attributable to the acquisition of the asset.

Basis of measurement

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

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

Cost model

The Group applies cost model to property, plant and equipment except for freehold land and buildings and records at cost of purchase or construction together with any incidental expenses thereon less accumulated depreciation and any accumulated impairment losses.

26. Property, plant and equipment (contd.) →

Revaluation model

The Group applies the revaluation model to the entire class of freehold land and buildings. Such properties are carried at a revalued amount, being their fair value at the date of revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Freehold land and buildings of the Group are revalued every three years or more frequently, if the fair values are substantially different from their carrying amounts to ensure that the carrying amounts do not differ materially from the fair values at the reporting date.

On revaluation of an asset, any increase in the carrying amount is recognised in Other Comprehensive Income and accumulated in equity, under capital reserve or used to reverse a previous revaluation decrease relating to the same asset, which was charged to Income Statement. In this circumstance, the increase is recognised as income to the extent of the previous write down. Any decrease in the carrying amount is recognised as an expense in the Income Statement or debited in the Other Comprehensive Income to the extent of any credit balance existing in the capital reserve in respect of that asset. The decrease recognised in Other Comprehensive Income reduces the amount accumulated in equity under capital reserves. Any balance remaining in the Revaluation Reserve in respect of an asset is transferred directly to Retained Earnings on retirement or disposal of the asset.

Derecognition

Property, plant and equipment are derecognised on disposal or when no future economic benefits are expected from its use. Any gain or loss arising on de-recognition 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.

Capital work in progress

These are expenses of capital nature directly incurred in the construction of buildings, major plant and machinery and system development, awaiting capitalisation. These are stated in the Statement of Financial Position at cost less any accumulated impairment losses. Capital work in progress is transferred to the relevant asset when it is in the location and condition necessary for it to be capable of operating in the manner intended by Management.

Borrowing Costs

There were no capitalised borrowing costs related to the acquisition of property, plant and equipment by the Bank.

Depreciation

Depreciation is recognised in profit or loss on 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. Depreciation rates for the identified classes of assets are as follows:

Improvement to rent/leasehold building

Effective from 1 January 2017 the Bank has decided to capitalised the improvement to rent/leasehold building. The improvement will be amortised over the lease period effective from same date.

Category of asset	Depreciation rate per annum (%)
Leasehold properties, improvement to rent/leasehold	Over the period of lease
Freehold buildings	2.5 p.a.
Office, sundry equipment and furniture and fittings	10 p.a.
Motor vehicles	20 p.a.
Computer hardware	20 p.a.
Computer software	25 p.a.

Effective from 1 January 2017 the rate of depreciation on computer hardware has been revised from 25% – 20% considering the useful life of the item.

The Group provides depreciation of an assets commence from the date when they are available for use to the date of disposal of the asset.

26. Property, plant and equipment (contd.)

26. (a) Property, plant and equipment – Bank – 2018

	Land and buildings Rs. '000	Leasehold properties, improvement to rent/ leasehold buildings* Rs. '000	Computer hardware Rs. '000	Computer software Rs. '000	Office sundry equipment, furniture and fittings ** Rs. '000	Motor vehicle Rs. '000	Building work-in-progress Rs. '000	Total Rs. '000
Cost/fair value								
Opening balance as at 1 January 2018	10,020,133	548,011	2,270,025	958,764	1,734,483	349,602	186,111	16,067,129
Additions	346,816	125,447	382,245	390,052	349,027	16,068	457,471	2,067,126
Disposals	(132,650)	(38,514)	(33,354)	(6,490)	(122,695)	(14)	(134,735)	(468,452)
Closing balance as at 31 December 2018	10,234,299	634,944	2,618,916	1,342,326	1,960,815	365,656	508,847	17,665,803
(Less): Accumulated depreciation								
Opening balance as at 1 January 2018	–	77,296	1,659,278	578,456	1,079,467	276,948	–	3,671,444
Charge for the year	52,203	18,781	208,131	187,796	136,893	34,992	–	638,795
Disposals	–	–	(32,061)	–	(78,116)	(14)	–	(110,191)
Closing balance as at 31 December 2018	52,203	96,077	1,835,348	766,251	1,138,244	311,926	–	4,200,048
(Less): Impairment	–	–	–	–	–	–	–	–
Net book value as at 31 December 2018	10,182,095	538,867	783,568	576,075	822,571	53,730	508,847	13,465,755

26. Property, plant and equipment (contd.)

26. (a) Property, plant and equipment – Bank – 2017

	Land and buildings Rs. '000	Leasehold properties, improvement to rent/ leasehold buildings* Rs. '000	Computer hardware Rs. '000	Computer software Rs. '000	Office sundry equipment, furniture and fittings ** Rs. '000	Motor vehicle Rs. '000	Building work-in-progress Rs. '000	Total Rs. '000
Cost/fair value								
Opening balance as at 1 January 2017	5,565,220	488,317	2,061,817	639,336	1,650,968	344,735	77,280	10,827,673
Adjustments	(1,500)	1,500	(128)	–	–	–	(15,785)	(15,913)
Additions	43,065	58,194	393,032	319,428	122,621	4,878	167,681	1,108,899
Revaluation	4,496,752	–	–	–	–	–	–	4,496,752
Depreciation adjustment for revalued assets	(83,404)	–	–	–	–	–	–	(83,404)
Disposals	–	–	(184,696)	–	(39,106)	(11)	(43,065)	(266,878)
Closing balance as at 31 December 2017	10,020,133	548,011	2,270,025	958,764	1,734,483	349,602	186,111	16,067,129
(Less): Accumulated depreciation								
Opening balance as at 1 January 2017	41,214	65,881	1,732,391	482,065	988,753	240,447	–	3,550,751
Charge for the year	42,190	11,415	111,180	96,391	125,860	36,512	–	423,547
Depreciation adjustment for revalued assets	(83,404)	–	–	–	–	–	–	(83,404)
Disposals	–	–	(184,293)	–	(35,146)	(11)	–	(219,450)
Closing balance as at 31 December 2017	–	77,296	1,659,278	578,456	1,079,467	276,948	–	3,671,444
(Less): Impairment	–	–	–	–	–	–	–	–
Net book value as at 31 December 2017	10,020,133	470,715	610,747	380,308	655,016	72,654	186,111	12,395,684

26. Property, plant and equipment (contd.)

26. (b) Property, plant and equipment – Group – 2018

	Land and buildings Rs. '000	Leasehold properties, improvement to rent/ leasehold buildings* Rs. '000	Computer hardware Rs. '000	Computer software Rs. '000	Office sundry equipment, furniture and fittings** Rs. '000	Motor vehicle Rs. '000	Building work-in-progress Rs. '000	Total Rs. '000
Cost/fair value								
Opening balance as at 1 January 2018	10,020,133	548,011	2,275,565	961,134	1,736,518	349,601	186,111	16,077,074
Additions	346,816	125,447	382,504	390,052	349,123	16,068	457,471	2,067,481
Disposals	(132,650)	(38,514)	(33,354)	(6,490)	(122,695)	(14)	(134,735)	(468,452)
Closing balance as at 31 December 2018	10,234,299	634,944	2,624,715	1,344,696	1,962,946	365,655	508,847	17,676,103
(Less): Accumulated depreciation								
Opening balance as at 1 January 2018	–	77,296	1,662,384	580,479	1,080,633	276,948	–	3,677,740
Charge for the year	52,203	18,781	208,890	187,875	137,038	34,992	–	639,779
Disposals	–	–	(32,061)	–	(78,116)	(14)	–	(110,191)
Closing balance as at 31 December 2018	52,203	96,077	1,839,213	768,354	1,139,554	311,926	–	4,207,328
(Less): Impairment	–	–	–		–	–	–	–
Net book value as at 31 December 2018	10,182,096	538,867	785,502	576,342	823,392	53,729	508,847	13,468,776

26. Property, plant and equipment (contd.)

26. (b) Property, plant and equipment – Group – 2017

	Land and buildings Rs. '000	Leasehold properties, improvement to rent/ leasehold buildings* Rs. '000	Computer hardware Rs. '000	Computer software Rs. '000	Office sundry equipment, furniture and fittings** Rs. '000	Motor vehicle Rs. '000	Building work-in-progress Rs. '000	Total Rs. '000
Cost/fair value								
Opening balance as at 1 January 2017	5,565,220	488,317	2,065,843	641,306	1,652,758	344,734	77,444	10,835,623
Adjustments	(1,500)	1,500	(128)	–	–	–	(15,949)	(16,077)
Additions	43,065	58,194	394,787	319,828	122,914	4,878	167,681	1,111,347
Revaluation	4,496,752	–	–	–	–	–	–	4,496,752
Depreciation adjustment for revalued assets	(83,404)	–	–	–	–	–	–	(83,404)
Disposals	–	–	(184,937)	–	(39,154)	(11)	(43,065)	(267,167)
Closing balance as at 31 December 2017	10,020,133	548,011	2,275,565	961,134	1,736,518	349,601	186,111	16,077,074
(Less): Accumulated depreciation								
Opening balance as at 1 January 2017	41,214	65,881	1,735,142	484,035	989,810	240,447	–	3,556,529
Charge for the year	42,190	11,415	111,776	96,444	126,015	36,512	–	424,352
Depreciation adjustment for revalued assets	(83,404)	–	–	–	–	–	–	(83,404)
Disposals	–	–	(184,534)	–	(35,192)	(11)	–	(219,737)
Closing balance as at 31 December 2017	–	77,296	1,662,384	580,479	1,080,633	276,948	–	3,677,740
(Less): Impairment	–	–	–	–	–	–	–	–
Net book value as at 31 December 2017	10,020,133	470,715	613,181	380,655	655,886	72,653	186,111	12,399,334

* Leasehold Properties, Improvement to Rent/Leasehold Buildings include working progress of improvement to rent/leasehold building amounting 54.2 Mn. as at 31 December 2018.

** Office, Sundry equipment and furniture & fittings include working progress of office equipment amounting Rs. 240,976 as at 31 December 2018.

26. Property, plant and equipment (contd.)

26. (c) Revaluation/fair valuation

The Bank has revalued its land and buildings, by professionally qualified independent valuers. The revaluation was carried out by taking into account the observable prices in active market or recent market transactions on arm's length basis. Accordingly a revaluation surplus, amounting to Rs. 4,478.48 Mn. had been credited to the Revaluation Reserve Account in 2017 and Rs. 11.73 Mn. had been adjusted to the same in relation to the prior year.

26. (d) Land and buildings of the Bank

Land and building balance include freehold land value of Rs. 8,076.4 Mn.

26. (e) Property, plant and equipment pledged as security for liabilities

There were no items of property, plant and equipment pledged as securities for liabilities.

26. (f) Fully-depreciated property, plant and equipment

The initial cost of fully-depreciated property, plant and equipment, which are still in use as at reporting date is as follows:

	Bank		Group	
As at 31 December	**2018 Rs. '000**	2017 Rs. '000	**2018 Rs. '000**	2017 Rs. '000
Computer hardware	**1,367,141**	1,370,615	**1,368,083**	1,371,270
Office equipment, furniture and fittings	**310,827**	271,677	**311,475**	271,975
Intangible assets	**470,562**	433,977	**472,531**	435,946
Others – sundry equipments	**431,765**	27,840	**432,679**	28,754

27 — Investment properties

The Bank and Group do not have investment properties.

28 — Goodwill and intangible assets

Accounting policy

The Group's intangible assets consist of the value of purchased computer software.

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 Group.

Basis of measurement

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is their fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses.

28. Goodwill and intangible assets (contd.)

Useful economic life and amortisation

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.

Derecognition

Intangible assets are 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.

The Group does not possess intangible assets with indefinite useful economic life. The estimated economic life of the Group's computer software is four years (25% per annum).

The Bank and Group do not have any intangible assets except computer software which has been disclosed under the property plant and equipment in Note 26.

29 — Deferred tax assets/liabilities

Accounting policy

Detailed discussion on deferred tax is given in Note 13 on page 286.

As at 31 December	Bank 2018 Rs. '000	Bank 2017 Rs. '000	Group 2018 Rs. '000	Group 2017 Rs. '000
29. (a) Deferred tax assets				
Opening balance	–	–	(75)	588
Charge for the year recognised in				
– profit and loss	–	–	148	(588)
– other comprehensive income	–	–	–	–
Closing balance	–	–	73	–
29. (b) Deferred tax liabilities				
Deferred tax liabilities	507,063	416,180	507,063	415,592
Income Statement	75,400	90,883	75,400	91,546
Net deferred tax liabilities	582,463	507,063	582,463	507,138

Notes to the Financial Statements

30 — Other assets →

As at 31 December	Bank 2018 Rs. '000	Bank 2017 Rs. '000	Group 2018 Rs. '000	Group 2017 Rs. '000
Cost				
Notional Tax/WHT receivable [refer Note 4 (d)]	**5,761,291**	7,184,079	**5,769,803**	7,212,333
Receivables	**4,714,573**	2,195,402	**5,029,529**	2,448,402
Receivable form treasury on interest (senior citizen)	**12,066,623**	8,150,352	**12,066,623**	8,150,352
Deposits and prepayments	**273,541**	363,458	**273,541**	363,458
Advance payment to treasury [refer Note (a)]	**4,160,000**	4,480,000	**4,160,000**	4,480,000
Advance payment made to pension II (refer Note 36)	**260,021**	46,384	**260,021**	46,384
Sundry debtors	**17,633**	27,436	**17,633**	27,436
Prepaid employee compensation	**3,790,398**	3,115,069	**3,790,398**	3,115,069
Other assets	**165,136**	133,509	**165,136**	133,509
Total	**31,209,216**	25,695,689	**31,532,684**	25,976,944

Note (a)
At the request of Treasury, the Bank paid an advance of Rs. 6,000 Mn. in 2012 and Rs. 2,000 Mn. in 2013 as confirmed by the Treasury to be set off against the profit within a period of six years starting from 2014. Effective from 1 January 2016, Treasury has agreed to set off the balance amount of Rs. 5,333 Mn. against the profit within a period of 10 years. There after Treasury has agreed to set off the balance amount of Rs. 4,800 Mn. against the profit within a period of 15 years effective from 1 January 2017.

31 — Due to banks →

Accounting policy

Due to banks represents overdrafts, call money borrowings, borrowing from banks and Repos by the subsidiary. Subsequent to initial recognition deposits are measured at their amortised cost using EIR method. Interest paid/payable on these dues are recognised in the Income Statement under Interest Expense. Foreign currency borrowings as at the reporting date are translated to the functional currency at the middle exchange rate of the functional currency at that date. Foreign currency differences arising on retranslation at the reporting date are recognised in profit or loss.

As at 31 December	Bank 2018 Rs. '000	Bank 2017 Rs. '000	Group 2018 Rs. '000	Group 2017 Rs. '000
Foreign currency borrowings (Note 31.1)	**18,183,425**	–	**18,183,425**	–
Securities sold under repurchase (Repo) agreements	**58,852,946**	48,416,152	**65,349,064**	49,172,135
Other facilities	**82,775**	180,439	**82,775**	180,439
Total	**77,119,146**	48,596,591	**83,615,264**	49,352,574

31. Due to banks (contd.)

31.1 Foreign currency borrowings

Name of lender	Loan value (USD)	Date of borrowing	Date of maturity
Commerzebank Finance and Covered Bond S.A.	100 Mn.	31.10.2018	31.10.2021

32 Derivative financial instruments

Bank and Group

As at 31 December	**Liabilities 2018 Rs. '000**	**Notional amount 2018 Rs. '000**	Liabilities 2017 Rs. '000	Notional amount 2017 Rs. '000
Interest rate derivatives				
Interest rate swaps	**1,533**	**2,000,000**	–	–
Foreign currency derivatives				
Currency swaps – (Note 19.2)	–	–	817,737	38,201,771
Forward foreign exchange contracts	–	–	139,200	3,064,600
Total	**1,533**	**2,000,000**	956,937	41,266,371

32.1 Swap agreement

Details	Description of the swaps
Swap instrument	Counter party – DFCC Bank
	Notional amount – Rs. 2,000 Mn.
Swap item	2,000 Mn. Term Loan to Sri Lanka Telecom (SLT) by DFCC
The period when the cash flows are expected to occur	Semi annual interest payment
Termination of agreement	20 February 2021
Base interest rate	6 months AWPLR (Average Weighted Prime Lending Rate)

33 Financial liabilities recognised through profit or loss

Accounting policy

The Bank and Group do not have instruments under the financial liabilities recognised through profit or loss.

Notes to the Financial Statements

34 — Financial liabilities at amortised cost

Accounting policy

Due to depositors include savings deposits and term deposits. Subsequent to initial recognition deposits are measured at their amortised cost using EIR method. Interest paid/payable on deposits are recognised in the Income Statement under Interest Expense.

Securities sold under repurchase agreements

Securities sold under agreements to repurchase at a specified future date are not derecognised from the Statement of Financial Position as the Group retains substantially all the risks and rewards of ownership. The corresponding cash received is recognised in the Consolidated Statement of Financial Position as financial liability reflecting as a loan received by the Group, including accrued interest as a liability within "Securities sold under repurchase agreements", reflecting the transaction's economic substance. The difference between the sale and repurchase prices is treated as interest expenses and is accrued over the life of agreement using the EIR.

	Bank		Group	
As at 31 December	**2018 Rs. '000**	2017 Rs. '000	**2018 Rs. '000**	2017 Rs. '000
Due to depositors	**839,574,411**	737,212,640	**839,574,411**	737,212,640
Due to debt securities holders	–	–	–	–
Due to other borrowers*	**14,804,802**	12,837,008	**21,750,178**	17,545,212
Total	**854,379,213**	750,049,648	**861,324,589**	754,757,852

* Due to other borrowers represent the securities sold under repurchase agreements.

34.1 Analysis of amount due to depositors

	Bank		Group	
As at 31 December	**2018 Rs. '000**	2017 Rs. '000	**2018 Rs. '000**	2017 Rs. '000
34.1 a By product				
Savings deposits	**198,321,926**	188,191,882	**198,321,926**	188,191,882
Fixed deposits	**641,252,485**	549,020,758	**641,252,485**	549,020,758
Total	**839,574,411**	737,212,640	**839,574,411**	737,212,640

	Bank		Group	
As at 31 December	**2018 Rs. '000**	2017 Rs. '000	**2018 Rs. '000**	2017 Rs. '000
34.1 b By currency				
Sri Lankan Rupee	**828,694,912**	727,849,199	**828,694,912**	727,849,199
United State Dollar	**7,341,154**	5,924,264	**7,341,154**	5,924,264
Euro	**1,314,681**	1,211,334	**1,314,681**	1,211,334
Great Britain Pound	**1,195,739**	1,207,599	**1,195,739**	1,207,599
Australian Dollar	**1,027,574**	1,020,083	**1,027,574**	1,020,083
Japanese Yen	**351**	161	**351**	161
Total	**839,574,411**	737,212,640	**839,574,411**	737,212,640

35 — Debt securities issued

As at 31 December	Bank 2018 Rs. '000	Bank 2017 Rs. '000	Group 2018 Rs. '000	Group 2017 Rs. '000
Issued by the bank				
Senior notes issued (Note 35.1)	**46,382,722**	156,702,616	**46,382,722**	156,702,616
Subordinated liabilities (Note 35.2)	**6,006,411**	6,006,411	**6,006,411**	6,006,411
Issued by other subsidiaries	**–**	–	**–**	–
Total	**52,389,133**	162,709,027	**52,389,133**	162,709,027
Due within 1 year	**46,389,133**	**118,401,527**	**46,389,133**	118,401,527
Due after 1 year	**6,000,000**	**44,307,500**	**6,000,000**	**44,307,500**
Total	**52,389,133**	162,709,027	**52,389,133**	162,709,027

35.1 Senior notes issued

Accounting policy

These represent the funds borrowed by the Bank for long-term funding requirement. It consists of borrowings through international bonds (USD denominated). Subsequent to initial recognition debt securities issued are measured at their amortised cost using EIR method. Interest paid/payable is recognised in profit or loss.

Foreign currency denominated debt securities as at the reporting date are translated to the functional currency at the middle exchange rate of the functional currency at that date. Foreign currency differences arising on retranslation at the reporting date are recognised in profit or loss.

Category	Face value	Issued rate %	Repayment terms	Issue date	Maturity date	Effective annual yield 2018 %	Effective annual yield 2017 %	Bank 2018 Rs. '000	Bank 2017 Rs. '000	Group 2018 Rs. '000	Group 2017 Rs. '000
Issued by the Bank											
750 Mn. US Dollar senior note	USD 750 Mn.	8.875	At maturity	18 September 2013	18 September 2018	**8.88**	8.88	**–**	117,831,970	**–**	117,831,970
250 Mn. US Dollar senior note	USD 250 Mn.	5.150	At maturity	10 September 2014	10 September 2019	**5.21**	5.21	**46,382,722**	38,870,646	**46,382,722**	38,870,646
								46,382,722	156,702,616	**46,382,722**	156,702,616

35. Debt securities issued (contd.)

35.2 Subordinated liabilities

Accounting policy

These represent the funds borrowed by the Group for long-term funding requirements. Subsequent to initial recognition these are measured at their amortised cost using the EIR method, except where the Group designates them at fair value through profit or loss. Interest paid/payable is recognised in profit or loss.

Primary objective of issuing debenture is to increase the capital of the Bank in order to enhance the capital adequacy ratio and reduce the maturity mismatch between the asset and liability portfolio of the Bank.

The Bank intends to utilise the entire proceeds of the issue to expand its asset base in the ordinary course of business.

Outstanding subordinated liabilities of the Bank as at 31 December 2018 consisted of Rs. 6,000,000,000.00 Rated, unsecured subordinated and redeemable debentures of Rs. 100.00 issued on 29 December 2016 as private placement under the provision of the NSB Act No. 30 of 1971. NSB Fund Management Co. Ltd. is act as Trustee for this debenture issue. The debenture carry AA+(lka) rating from the Fitch Rating Lanka.

Category	Face value	Interest rate	Repayment terms	Issue date	Maturity date	Effective annual yield		Bank		Group	
						2018 %	2017 %	**2018 Rs. '000**	2017 Rs. '000	**2018 Rs. '000**	2017 Rs. '000
Issued by the Bank											
Fixed rate 13%	6,000,000	13% p.a.	Semi-annually	29 December 2016	29 December 2021	**13.42**	13.42	**6,000,000**	6,000,000	**6,000,000**	6,000,000
								6,000,000	6,000,000	**6,000,000**	6,000,000

In the event of the winding-up of the issuer, the above liabilities would be subordinated to the claims of depositors and all other creditors of the issuer.

36 Retirement benefit obligations

Accounting policy

The unfunded past service cost is recognised in other comprehensive Income immediately upon actuarial valuation.

As at 31 December	Bank		Group	
	2018 Rs. '000	2017 Rs. '000	**2018 Rs. '000**	2017 Rs. '000
Provision for pension scheme I [Note 36 (a) 1]	**2,596,088**	2,750,601	**2,596,088**	2,750,601
Provision for pension scheme II [Note 36 (a) 2]	–	–	–	–
Provision for medical assistance scheme [Note 36 (a) 3]	**1,234,707**	960,830	**1,234,707**	960,830
Provision for gratuity [Note 36 (a) 4]	–	–	**1,982**	1,234
Total	**3,830,795**	3,711,431	**3,832,777**	3,712,665

36. Retirement benefit obligations (contd.)

36. (a) Defined benefit plans

The Bank has two separate pension schemes established, Pension Scheme I for permanent employees joined before 1 October 1995 and Pension Scheme II for permanent employees joined on or after 1 October 1995 and a medical assistance scheme for retired employees.

The assets of these schemes are held independently of the Bank's assets and administered by Boards of Trustees/Managers, representing the Management and the employees, as provided in the trust deed/rules of the respective funds.

All the funds are subject to annual audits independent to the audit of the Bank, by a firm of Chartered Accountants appointed by the members and actuarial valuations are carried out at least once in every two years, as per the rules governing these funds.

36. (a) 1 National savings bank employees' pension scheme I

Pension Scheme I

An actuarial valuation was carried out by Mr Piyal S Goonetilleke, fellow of Society of Actuaries (USA) of Piyal S Goonetilleke & Associates, on 31 December 2018.

Projected Unit Credit Method was used to allocate the actuarial present value of the projected benefits earned by employees to date of 31 December 2018.

	Bank		Group	
	2018 Rs. '000	2017 Rs. '000	**2018 Rs. '000**	2017 Rs. '000
(a) Net asset/(liability) recognised in Statement of Financial Position				
Present value of defined benefit obligation	**(16,184,005)**	(16,303,208)	**(16,184,005)**	(16,303,208)
Fair value of plan assets	**13,587,917**	13,552,607	**13,587,917**	13,552,607
Total	**(2,596,088)**	(2,750,601)	**(2,596,088)**	(2,750,601)
(b) Amount recognised in income statement				
Current service cost	**117,515**	137,244	**117,515**	137,244
Interest cost on benefit obligation	**405,421**	254,833	**405,421**	254,833
Adjustments	**–**	–	**–**	–
Net benefit expense	**522,936**	392,077	**522,936**	392,077
(c) Amount recognised in other comprehensive income (OCI)				
Provision adjustment	**–**	–	**–**	–
Experience (gain)/loss	**801,418**	526,139	**801,418**	526,139
(Gain)/loss due to changes in assumptions	**(1,105,366)**	1,062,775	**(1,105,366)**	1,062,775
Actuarial gain/(loss) on plan assets	**149,435**	(90,866)	**149,435**	(90,866)
Difference in interest income on plan assets	**–**	–	**–**	–
Total	**(154,513)**	1,498,048	**(154,513)**	1,498,048

36. Retirement benefit obligations (contd.)

36. (a) Defined benefit plans (contd.)

36. (a) 1 National savings bank employees' pension scheme I (contd.)

	Bank		Group	
	2018 Rs. '000	2017 Rs. '000	**2018 Rs. '000**	2017 Rs. '000
(d) Changes in fair value of plan assets are as follows:				
Opening fair value of plan assets	**13,552,607**	13,198,392	**13,552,607**	13,198,392
Expected return on plan assets	**1,387,932**	1,479,280	**1,387,932**	1,479,280
Actual employer contribution	**522,936**	392,077	**522,936**	392,077
Benefits paid	**(1,726,123)**	(1,608,008)	**(1,726,123)**	(1,608,008)
Actuarial gain/(loss) on plan assets	**(149,435)**	90,866	**(149,435)**	90,866
Closing fair value of plan assets	**13,587,917**	13,552,607	**13,587,917**	13,552,607
(e) Changes in present value of defined benefit obligation are as follows:				
Opening defined benefit obligation	**16,303,208**	14,450,945	**16,303,208**	14,450,945
Interest cost	**1,793,353**	1,734,113	**1,793,353**	1,734,113
Current service cost	**117,515**	137,243	**117,515**	137,243
Benefits paid	**(1,726,123)**	(1,608,008)	**(1,726,123)**	(1,608,008)
(Gain)/loss due to changes in assumptions	**(1,105,366)**	1,062,775	**(1,105,366)**	1,062,775
Actuarial (gain)/loss on obligation	**801,418**	526,140	**801,418**	526,140
Closing defined benefit obligation	**16,184,005**	16,303,208	**16,184,005**	16,303,208
(f) Plan assets consists of followings:				
Treasury Bonds	**6,918,796**	7,438,650	**6,918,796**	7,438,650
Treasury Bills	**–**	237,424	**–**	237,424
Fixed deposits	**501,333**	267,939	**501,333**	267,939
Securities purchased under resale agreements	**139,087**	242,285	**139,087**	242,285
Debentures	**5,816,455**	4,699,545	**5,816,455**	4,699,545
Trust certificate	**103,063**	100,000	**103,063**	100,000
Cash at Bank	**82**	52	**82**	52
Other assets	**109,101**	566,712	**109,101**	566,712
Total	**13,587,917**	13,552,607	**13,587,917**	13,552,607

	Pension Scheme I 2018	Pension Scheme I 2017
(g) Actuarial assumption		
Future salary increment rate (%)	**6.50**	6.50
Discount rate (%)	**12.00**	11.00
Increase in future Cost of Living Allowance (COLA) (%)	**4.50**	4.50
Mortality	**GA 1983 Mortality table**	GA 1983 Mortality table
Retirement age	**57 years**	57 years
Normal form of payment	**Monthly**	Monthly

36. Retirement benefit obligations (contd.)

36. (a) Defined benefit plans (contd.)

36. (a) 1 National savings bank employees' pension scheme I (contd.)

Turnover rate

Age	2018 %	2017 %
20	**2**	2
25	**1.5**	1.5
30	**1**	1
35	**1**	1
40	**1**	1
45	**1**	1
50	**1**	1
55	**–**	–

(h) Increase/decrease in the following assumptions will have an impact on the present value of defined benefit obligation as illustrated below:

	Bank and Group 2018		Bank and Group 2017	
	Pension Scheme I		Pension Scheme I	
	1% increase	**1% decrease**	1% increase	1% decrease
Future salary increment rate	**16,239,064**	**16,131,138**	16,333,406	16,274,156
Discount rate	**15,206,625**	**17,289,679**	15,240,433	17,513,994

36. (a) 2 National savings Bank employee's pension scheme II

An actuarial valuation was carried out by Mr Piyal S Goonetilleke, Fellow of Society of Actuaries (USA) of Piyal S Goonetilleke & Associates, on 31 December 2018.

Projected Unit Credit Method was used to allocate the actuarial present value of the projected benefits earned by employees to date of 31 December 2018.

	Bank		Group	
As at 31 December	**2018 Rs. '000**	2017 Rs. '000	**2018 Rs. '000**	2017 Rs. '000
(a) Net asset/(liability) recognised in Statement of Financial Position				
Present value of defined benefit obligation	**(1,918,831)**	(1,481,223)	**(1,918,831)**	(1,481,223)
Fair value of plan assets	**2,178,685**	1,527,607	**2,178,685**	1,527,607
Adjustment	**167**	–	**167**	–
Total	**260,021**	46,384	**260,021**	46,384
(b) Amount recognised in Income Statement				
Current service cost	**172,533**	106,574	**172,533**	106,906
Interest cost on benefit obligation	**(4,747)**	(9,334)	**(4,747)**	(9,334)
Net benefit expense	**167,786**	97,240	**167,786**	97,572

36. Retirement benefit obligations (contd.)

36. (a) Defined benefit plans (contd.)

36. (a) 2 National savings Bank employee's pension scheme II (contd.)

As at 31 December	Bank 2018 Rs. '000	Bank 2017 Rs. '000	Group 2018 Rs. '000	Group 2017 Rs. '000
(c) Amount recognised in other comprehensive income (OCI)				
Provision adjustment	–	–	–	–
Experience (gain)/loss	**463,865**	16,090	**463,865**	16,090
(Gain)/loss due to changes in assumptions	**(355,768)**	236,887	**(355,768)**	236,887
Actuarial gain/(loss) on plan assets	**(15,379)**	4,947	**(15,379)**	4,947
Difference in interest income on plan assets	–	–	–	–
	92,718	257,924	**92,718**	257,924
(d) Changes in fair value of plan assets are as follows:				
Opening fair value of plan assets	**1,527,607**	1,086,586	**1,527,607**	1,086,586
Expected return on plan assets	**167,682**	130,046	**167,682**	130,046
Actual employer contribution	**473,974**	321,223	**473,974**	321,223
Benefits paid	**(5,957)**	(5,302)	**(5,957)**	(5,302)
Actuarial gain/(loss) on plan assets	**15,379**	(4,947)	**15,379**	(4,947)
Closing fair value of plan assets	**2,178,685**	1,527,607	**2,178,685**	1,527,607
(e) Changes in present value of defined benefit obligation are as follows:				
Opening defined benefit obligation	**1,481,223**	1,005,930	**1,481,223**	1,005,930
Interest cost	**162,935**	120,712	**162,935**	120,712
Current service cost	**172,533**	106,906	**172,533**	106,906
Benefits paid	**(5,957)**	(5,302)	**(5,957)**	(5,302)
(Gain)/loss due to changes in assumptions	**(355,768)**	236,887	**(355,768)**	236,887
Actuarial (gain)/loss on obligation	**463,865**	16,090	**463,865**	16,090
Closing defined benefit obligation	**1,918,831**	1,481,223	**1,918,831**	1,481,223
(f) Plan assets consist of followings:				
Treasury Bonds	**1,864,180**	1,376,780	**1,864,180**	1,376,780
Treasury Bills	**37,418**	–	**37,418**	–
Fixed deposits	**225,867**	140,747	**225,867**	140,747
Securities purchased under resale agreements	**74,632**	2,161	**74,632**	2,161
Savings	**56**	1,006	**56**	1,006
Other assets/(liabilities)	**(23,468)**	6,913	**(23,468)**	6,913
Total	**2,178,685**	1,527,607	**2,178,685**	1,527,607

36. Retirement benefit obligations (contd.)

36. (a) Defined benefit plans (contd.)

36. (a) 2 National savings Bank employee's pension scheme II (contd.)

	Pension Scheme II 2018	Pension Scheme II 2017
(g) Actuarial assumption		
Future salary increment rate (%)	**6.50**	6.50
Discount rate (%)	**12.00**	11.00
Increase in future cost of living allowance (COLA) (%)	**4.50**	4.50
Mortality	**GA 1983 mortality table**	GA 1983 mortality table
Retirement age	**57 years**	57 years
Normal form of payment	**Monthly**	Monthly

Turnover rate

Age	**2018 %**	2017 %
20	**2**	2
25	**1.5**	1.5
30	**1**	1
35	**1**	1
40	**1**	1
45	**1**	1
50	**1**	1
55	**–**	–

(h) Increase/decrease in the following assumptions will have an impact on the present value of defined benefit obligation as illustrated below:

	Bank and Group			
	2018		2017	
	1% increase	**1% decrease**	1% increase	1% decrease
Future salary increment rate	**2,153,504**	**1,718,957**	1,666,712	1,323,749
Discount rate	**1,636,760**	**2,274,599**	1,244,336	1,784,570

36. (a) 3 Medical assistance scheme for the retired employees of NSB

An actuarial valuation was carried out by Mr Piyal S Goonetilleke, Fellow of Society of Actuaries (USA) of Piyal S Goonetilleke & Associates, on 31 December 2018.

Projected Unit Credit Method was used to allocate the actuarial present value of the projected benefits earned by employees to date of 31 December 2018.

36. Retirement benefit obligations (contd.)

36. (a) Defined benefit plans (contd.)

36. (a) 3 Medical assistance scheme for the retired employees of NSB (contd.)

As at 31 December	2018 Rs. '000	2017 Rs. '000
(a) Net asset/(liability) recognised in statement of financial position		
Present value of defined benefit obligation	**(1,523,918)**	(1,230,477)
Fair value of plan assets	**289,211**	283,336
Less:		
Contribution from employees	–	(13,689)
Total	**(1,234,707)**	(960,830)
(b) Amount recognised in income statement		
Current service cost	**24,475**	9,393
Interest cost on benefit obligation	**111,195**	86,715
Net benefit expense	**135,670**	96,108
(c) Amount recognised in other comprehensive income (OCI)		
Provision adjustment	**(28,608)**	–
Experience (gain)/loss	**467,826**	235,163
(Gain)/loss due to changes in assumptions	**(132,004)**	94,023
Actuarial gain/(loss) on plan assets	**(10,960)**	(12,733)
Total	**296,254**	316,452
(d) Changes in fair value of plan assets are as follows:		
Opening fair value of plan assets	**283,336**	300,986
Expected return on plan assets	**21,010**	25,820
Actual employer contribution	**135,670**	96,108
Actual participants' contribution	**8,688**	6,114
Benefits paid	**(170,454)**	(158,425)
Actuarial gain/(loss) on plan assets	**10,960**	12,733
Closing fair value of plan assets	**289,211**	283,336
(e) Changes in present value of defined benefit obligation are as follows:		
Opening defined benefit obligation	**1,230,477**	937,788
Provision adjustment	**(28,608)**	–
Interest cost	**132,206**	112,535
Current service cost	**24,475**	9,393
Benefits paid	**(170,454)**	(158,425)
(Gain)/loss due to changes in assumptions	**(132,004)**	94,023
Actuarial (gain)/loss on obligation	**467,826**	235,163
Closing defined benefit obligation	**1,523,918**	1,230,477

36. Retirement benefit obligations (contd.)

36. (a) Defined benefit plans (contd.)

36. (a) 3 Medical assistance scheme for the retired employees of NSB (contd.)

As at 31 December	2018 Rs. '000	2017 Rs. '000
(f) Plan assets consists of followings:		
Treasury Bonds	**214,229**	154,270
Fixed deposits	**73,275**	99,224
Securities purchased under resale agreements	**10,075**	7,615
Trust certificate	**31,666**	83,342
Savings	**51**	484
Other payable	**(40,084)**	(61,599)
Total	**289,211**	283,336
(g) Actuarial assumption		
Medical cost inflation rate (%)	**5.00**	5.00
Discount rate (%)	**12.00**	11.00

36. (a) 4 Gratuity plan – Bank and Group

Bank

With the establishment of Pension Scheme II, employees who joined the Bank on or after 1 October 1995 are become members of the Pension Scheme II, thus are not entitle to the rights and privileges under Service Gratuity Scheme. However, where there are payment of termination gratuity before the entitlement pension of Bank recognise the expense on cash basis.

Group

The staff members of the subsidiary company is not entitled for pension scheme and hence they are continue to the members of Gratuity plan as per the provision of Gratuity Act No. 12 of 1983.

	Bank		Group	
	2018 Rs. '000	2017 Rs. '000	2018 Rs. '000	2017 Rs. '000
(a) Net benefit expense (recognised under personal expenses)				
Current service cost	–	–	**202**	119
Interest cost on benefit obligation	–	–	**149**	125
Net benefit expense	–	–	**351**	244
(b) Provision for gratuity				
Defined benefit obligation as at 1 January	–	–	**1,234**	1,260
Interest cost	–	–	**149**	125
Current service cost	–	–	**202**	119
Benefits paid	–	–	–	–
Actuarial (gain)/loss on obligation (recognised in OCI)	–	–	**397**	(270)
Defined benefit obligation as at 31 December	–	–	**1,982**	1,234

36. Retirement benefit obligations (contd.)

36. (a) Defined benefit plans (contd.)

36. (a) 4 Gratuity plan – Bank and Group (contd.)

		Group	
		2018 %	2017 %
(c) Actuarial assumption			
Future salary increment rate		**8.33**	6.59
Discount rate		**12.11**	10.63
Mortality		**0**	0
Staff turnover rate and average future working lifetime			
Age group	30-34	**35-39**	>40
Staff turnover rate	0%	**0%**	0%
Average future working lifetime – Years	29	**25**	17

(d) Increase/decrease in the following assumptions will have an impact on the present value of defined benefit obligation as illustrated below:

Values appearing in the Financial Statements are very sensitive to the changes in financial and non-financial assumptions used. A sensitivity was carried out as follows:

	Group			
	2018		2017	
	1% increase	**1% decrease**	1% increase	1% decrease
Future salary increment rate	**349**	**(295)**	219	(183)
Discount rate	**(284)**	**296**	(191)	226

Assumptions

Financial Assumptions – Rate of discount, Salary increment rate

Demographic Assumptions – Mortality, Staff turn over, Disability, Retirement age

37 Current tax liabilities

As at 31 December	Bank		Group	
	2018 Rs. '000	2017 Rs. '000	**2018 Rs. '000**	2017 Rs. '000
Balance as at 1 January	–	–	**137,344**	17,153
Charge for the year	–	–	**2,991**	175,692
Payment during the year	–	–	**(168,197)**	(55,501)
Balance as at 31 December	–	–	**(27,862)**	137,344

Note: Current tax asset classified in other assets.

38 — Other provisions

No value to be disclosed under Other Provisions.

39 — Other liabilities

Accounting policy

Other liabilities include provisions made in account of interests, fees and expenses, pensions, leave encashment and other expenses. These liabilities are recorded at amounts expected to be payable at reporting date.

As at 31 December	Bank		Group	
	2018 Rs. '000	2017 Rs. '000	**2018 Rs. '000**	2017 Rs. '000
Sundry creditors	**172,333**	119,903	**172,333**	119,903
Unamortised day one difference currency swap (refer Note 19.2)	**–**	1,099,322	**–**	1,099,322
Salary related payable	**935,974**	654,455	**935,974**	654,455
Other tax payable	**646,009**	771,153	**646,009**	771,153
Other payables	**3,692,960**	2,705,412	**3,698,001**	2,749,963
Total	**5,447,277**	5,350,244	**5,452,317**	5,394,795

40 — Due to subsidiaries

As at 31 December	Bank		Group	
	2018 Rs. '000	2017 Rs. '000	**2018 Rs. '000**	2017 Rs. '000
Payable to FMC	**750**	750	**–**	–
Total	**750**	750	**–**	–

Note: Refer Note 47 (b) – Related party transactions on page 338.

41 — Stated capital/Assigned capital

As at 31 December	Bank 2018 Rs. '000	Bank 2017 Rs. '000	Group 2018 Rs. '000	Group 2017 Rs. '000
Authorised				
One billion ordinary share of Rs. 10.00 each as at 1 January	**10,000,000**	10,000,000	**10,000,000**	10,000,000
Balance as at 1 January (issued and fully paid)				
670 Mn. ordinary shares of Rs. 10.00 each	**6,700,000**	6,200,000	**6,700,000**	6,200,000
Issue of ordinary shares during the year				
270 Mn. ordinary shares of Rs. 10.00 each	**2,700,000**	500,000	**2,700,000**	500,000
Total	**9,400,000**	6,700,000	**9,400,000**	6,700,000

As per section 47 of NSB Act sub section 3, bank has issued 270 Mn. ordinary shares of Rs. 10.00 using unclaimed deposit reserve to the secretary to the Treasury on 31 December 2018. (Refer Note 44.1 unclaimed deposit reserve page 334)

42 — Statutory reserve fund

The statutory reserve fund is maintained as per the requirements under Section 20 (1) of the Banking Act No. 30 of 1988. Accordingly, the fund is built up by allocating a sum equivalent to not less than 5% of the profit after tax, but before declaring any dividend or any profit that are transferred to elsewhere until the reserve is equal to 50% of the Bank's stated capital and thereafter sum equivalent to 2% of such profit until the amount of said reserve fund is equal to the stated capital of the Bank.

The balance in the statutory reserve fund will be used only for the purposes specified in the Section 20 (2) of the Banking Act No. 30 of 1988.

As at 31 December	Bank 2018 Rs. '000	Bank 2017 Rs. '000	Group 2018 Rs. '000	Group 2017 Rs. '000
Opening balance	**3,002,952**	2,522,467	**3,002,952**	2,522,467
Transfer during the period – 5% of profit after tax	**225,008**	480,485	**225,008**	480,485
Closing balance	**3,227,960**	3,002,952	**3,227,960**	3,002,952

43 — Retained earnings

As at 31 December	Bank 2018 Rs. '000	Bank 2017 Rs. '000	Group 2018 Rs. '000	Group 2017 Rs. '000
Balance as at 1 January	**1,102,798**	2,379,307	**1,679,540**	3,708,614
Impact of adopting SLFRS 9	–	(1,232,348)	–	(1,232,437)
Restated opening balance under SLFRS 9	**1,102,798**	1,146,959	**1,679,540**	2,476,177
Profit for the year	**4,500,151**	9,715,961	**4,500,187**	9,156,396
Other comprehensive income	**(210,861)**	(2,072,425)	**(211,258)**	(2,072,155)
Transfers to other reserves	**(225,008)**	(2,480,485)	**(225,016)**	(2,571,184)
Contribution to national insurance trust fund	**(45,002)**	(96,097)	**(45,002)**	(96,097)
Withholding tax on dividend	–	–	–	(102,483)
Dividend	**(500,000)**	(5,111,114)	**(500,000)**	(5,111,114)
Balance as at 31 December	**4,622,080**	1,102,798	**5,198,451**	1,679,540

44 — Other reserves

Bank 2018

	Opening balance at 1 January 2018 Rs. '000	**Movement/ transfers Rs. '000**	**Closing balance at 31 December 2018 Rs. '000**
General reserve	**17,740,879**	–	**17,740,879**
Revaluation reserve	**7,793,317**	–	**7,793,317**
OCI reserve	**1,345,237**	**(816,806)**	**528,430**
Cash flow hedging reserve	**291,924**	**(291,924)**	–
Foreign currency translation reserve	–	–	–
Other reserves (refer Notes 44.1 and 44.2)	**1,118,586**	**(698,587)**	**419,999**
Total	**28,289,941**	**(1,807,316)**	**26,482,625**

Bank 2017

	Opening balance at 1 January 2017 Rs. '000	Movement/ transfers Rs. '000	Closing balance at 31 December 2017 Rs. '000
General reserve	15,740,879	2,000,000	17,740,879
Revaluation reserve	3,296,565	4,496,752	7,793,317
OCI reserve	1,378,818	(33,581)	1,345,237
Cash flow hedging reserve	1,850	290,074	291,924
Foreign currency translation reserve	–	–	–
Other reserves (refer Notes 44.1 and 44.2)	725,695	392,891	1,118,586
Total	21,143,806	7,146,136	28,289,941

44. Other reserves (contd.)

Group 2018

	Opening balance at 1 January 2018 Rs. '000	Movement/ transfers Rs. '000	Closing balance at 31 December 2018 Rs. '000
General reserve	**17,740,879**	**–**	**17,740,879**
Revaluation reserve	**7,793,317**	**–**	**7,793,317**
OCI reserve	**1,228,420**	**(838,210)**	**390,211**
Cash flow hedging reserve	**291,924**	**(291,924)**	**–**
Foreign currency translation reserve	**–**	**–**	**–**
Other reserves (refer Notes 44.1, 44.2 and 44.3)	**1,703,246**	**(698,578)**	**1,004,668**
Total	**28,757,786**	**(1,828,712)**	**26,929,074**

Group 2017

	Opening balance at 1 January 2017 Rs. '000	Movement/ transfers Rs. '000	Closing balance at 31 December 2017 Rs. '000
General reserve	15,740,879	2,000,000	17,740,879
Revaluation reserve	3,296,565	4,496,752	7,793,317
OCI reserve	1,096,758	131,662	1,228,420
Cash flow hedging reserve	1,850	290,074	291,924
Foreign currency translation reserve	–	–	–
Other reserves (refer Notes 44.1, 44.2 and 44.3)	1,219,656	483,590	1,703,246
Total	21,355,707	7,402,077	28,757,786

44.1 Unclaimed deposit reserve

	Bank		Group	
As at 31 December	**2018 Rs. '000**	2017 Rs. '000	**2018 Rs. '000**	2017 Rs. '000
Opening balance	**1,116,401**	723,509	**1,116,401**	723,509
Transferred to share capital	**(2,700,000)**	(500,000)	**(2,700,000)**	(500,000)
Transferred during the year	**2,001,414**	892,892	**2,001,414**	892,892
Closing balance	**417,815**	1,116,401	**417,815**	1,116,401

In terms of the Section 47 of the National Savings Bank Act No. 30 of 1971 as amended by the Section 30 of the National Savings Bank (Amendment) Act No. 28 of 1995, where an amount lain dormant in a savings or deposit account for a period of ten years, it should be transferred to Unclaimed Deposit Reserve. Accordingly amount transferred (net) to the reserve during the year 2018, was Rs. 2,001.4 Mn.

44. Other reserves (contd.)

44.2 Special reserve

As at 31 December	Bank 2018 Rs. '000	Bank 2017 Rs. '000	Group 2018 Rs. '000	Group 2017 Rs. '000
Opening balance	**2,185**	2,186	**2,185**	2,186
Transferred during the year	**(1)**	(1)	**(1)**	(1)
Closing balance	**2,184**	2,185	**2,184**	2,185

The special reserve represents the amount transferred from the dormant accounts of customers where the aggregate of the amount dormant is less than Rs. 10.00 (Ten rupees)

The whole or such part of the monies lying to the credit of "Special Reserve" and "Unclaimed Deposit Reserve" may be capitalised and shares to the value of money capitalised may be issued in the name of Secretary to the Treasury. The entirety of the issue and fully-paid share capital of Rs. 9,400 Mn. reflected in the Statement of Financial Position was issued by capitalising the unclaimed deposit reserve time to time.

44.3 Special risk reserve – (NSB Fund Management Company Limited)

As at 31 December	Bank 2018 Rs. '000	Bank 2017 Rs. '000	Group 2018 Rs. '000	Group 2017 Rs. '000
Opening balance	–	–	**584,660**	493,961
Transferred during the year – 25% of profit after tax	–	–	**9**	90,699
Closing balance	–	–	**584,669**	584,660

In order to promote the safety, soundness and the stability of the primary dealer (PD) system and to build up PD capital base, primary dealers (PDs) are required to annually transfer a percentage of their profit after tax to a special risk reserve as follows, with effect from 1 July 2004.

I. 50% of the profit after tax annually by the PDs who maintain capital funds less than Rs. 400 Mn.

II. 25% of the profit after tax annually by the PDs who maintain capital funds in excess of Rs. 400 Mn.

As at 31 December	Bank 2018 Rs. '000	Bank 2017 Rs. '000	Group 2018 Rs. '000	Group 2017 Rs. '000
Other reserves				
Total other reserves	**419,999**	1,118,586	**1,004,668**	1,703,246

45 — Non-controlling interest

No values to be disclosed under non-controlling interest.

46 — Contingent liabilities and commitments

Accounting policy

Contingent liabilities are possible obligations whose existence will be confirmed only by uncertain future event or present obligation where the transfer of economic benefit is not probable or cannot be reliably measured as defined in the Sri Lanka Accounting Standard – LKAS 37 on "Provisions, Contingent Liabilities and Contingent Assets".

To meet the financial needs of customers, the Bank enters in to various irrevocable commitments and contingent liabilities. These consist of finance guarantees, letters of credit and other undrawn commitments to lend. Letters of credit and guarantees commit the Bank to make payments on behalf of customers in the event of a specific act, generally related to the import or export of goods. Guarantees and standby letters of credit carry a similar credit risk to loans.

Contingent liabilities are not recognised in the Statement of Financial Position but are disclosed unless its occurrence is remote.

	Bank		Group	
As at 31 December	**2018 Rs. '000**	2017 Rs. '000	**2018 Rs. '000**	2017 Rs. '000
Commitment for unutilised credit facilities	**1,579,548**	14,963,565	**1,579,548**	14,963,565
Other commitments indirect credit facilities	**57,525**	78,648	**57,525**	78,648
Capital commitments (Note 46.1)	**678,624**	1,260,213	**678,624**	1,260,213
	2,315,697	16,302,426	**2,315,697**	16,302,426
Contingent liabilities				
Documentary credit	**277,937**	276,003	**277,937**	276,003
Guarantees	**1,887,763**	1,741,883	**1,887,763**	1,741,883
	2,165,700	2,017,886	**2,165,700**	2,017,886
Total commitment and contingencies	**4,481,397**	18,320,312	**4,481,397**	18,320,312

46.1 Capital commitments

Capital expenditure approved by the Board of Directors, for which provisions have not been made in the Financial Statements are detailed below:

	Bank		Group	
As at 31 December	**2018 Rs. '000**	2017 Rs. '000	**2018 Rs. '000**	2017 Rs. '000
Approved and contracted for	**498,624**	1,187,213	**498,624**	1,187,213
Approved but not contracted for	**180,000**	73,000	**180,000**	73,000
	678,624	1,260,213	**678,624**	1,260,213

47 — Related party disclosures

Accounting policy

The Bank carried out transactions in the ordinary course of business on an arm's length basis at commercial rates with parties who are defined as related parties as per the Sri Lanka Accounting Standard – LKAS 24 – "Related Party Disclosures", other than, transactions that the Key Management Personnel (KMP) have availed under schemes uniformly applicable to all staff at concessionary rates.

47. (a) Transactions with state and state-controlled entities

The financial dealings carried out with the Government of Sri Lanka and state-controlled entities for the year and as of the date of the Statement of Financial Position are disclosed below on a collective basis:

As at 31 December	Bank		Group	
	2018 Rs. '000	2017 Rs. '000	**2018 Rs. '000**	2017 Rs. '000
Assets				
Loans to Government	**2,075,000**	2,075,000	**2,075,000**	2,075,000
Investments made on Government Securities	**523,205,915**	550,064,186	**538,670,193**	556,857,496
Investments on state and state-controlled entities	**148,027,411**	151,145,775	**148,027,411**	151,145,775
Securities purchased under resale agreements	**1,432,088**	1,660,634	**1,432,088**	1,672,197
Tax receivable (notional tax)	**5,761,291**	7,184,079	**5,769,803**	7,212,333
Postmaster-General's current account	**376,392**	351,107	**376,392**	351,107
Advance payment to Government	**4,160,000**	4,480,000	**4,160,000**	4,480,000
Other receivables from Government	**14,942,050**	8,426,009	**14,942,050**	8,426,009
	699,980,147	725,386,790	**715,452,937**	732,219,917
Liabilities				
Securities sold under repurchase agreements	**60,456,305**	21,708,120	**60,456,305**	27,297,637
Taxes paid				
Income tax	**3,441,213**	4,419,019	**3,444,056**	4,595,065
Value added tax	**2,577,657**	3,082,619	**2,584,220**	3,168,299
Nation building tax	**343,688**	411,016	**344,563**	422,440
Debt repayment levy	**308,371**	–	**308,371**	–
Contribution to consolidated fund – dividend/levy	**500,000**	5,111,114	**500,000**	5,111,114
	7,170,929	13,023,768	**7,181,210**	13,296,918

47. Related party disclosures (contd.)

47. (b) Transactions with subsidiary company (NSB Fund Management Company limited)

The Bank has contributed Rs. 800 Mn. towards the share capital of the Company. The Company invested its funds in Treasury Bills, Treasury Bonds and Repos during the year on a regular basis. All investment in Treasury Bills and Treasury Bonds of the Bank are being made through the NSB Fund Management Co. Ltd., on which a service charge of Rs. 39.4 Mn. has been made (Rs. 58.7 Mn. in 2017).

The Bank holds following balances with NSB Fund Management Company Ltd. at the reporting date.

	Bank	
As at 31 December	**2018 Rs. '000**	2017 Rs. '000
Assets		
Inter-company current account	**41**	51
Securities purchased under resale agreement	–	1,564,600
Interest receivable on securities purchased under resale agreement	–	1,326
Other receivable	**164**	955
Liabilities		
Other payable	**750**	750

	Bank	
As at 31 December	**2018 Rs. '000**	2017 Rs. '000
Income		
Rent income	**1,874**	1,874
Interest income reverse repo	**7,885**	170,401
Expenses		
Service charges	**39,421**	58,747
RTGS charges	**992**	695
Custodian fee	**6,000**	6,000
Trustee fee	**500**	500
Interest expenses on repo	**46,105**	–

47. Related party disclosures (contd.)

47. (c) Transactions with post-employment benefit plans of the Bank

Financial position transactions which were taken place between the Bank and Post-Employment Benefit Plans of the Bank as at the year end are summarised below:

As at 31 December	Bank 2018 Rs. '000	Bank 2017 Rs. '000	Group 2018 Rs. '000	Group 2017 Rs. '000
National Savings Bank Employees' Provident Fund				
Liabilities				
Fixed deposits	**186,800**	–	**186,800**	–
Securities purchased under resale agreements	–	36,637	–	36,637
Debentures	**125,000**	125,000	**125,000**	125,000
Assets				
Repo borrowings	–	28,068	–	28,068
Liabilities				
National Savings Bank Employees' Pension Scheme I				
Fixed deposits	**394,810**	394,810	**394,810**	263,813
Securities purchased under resale agreements	**139,087**	139,087	**139,087**	242,643
Debentures	**1,700,000**	1,700,000	**1,700,000**	1,700,000
National Savings Bank Employees' Pension Scheme II				
Fixed deposits	**106,617**	140,373	**106,617**	140,373
Securities purchased under resale agreements	**74,548**	3,137	**74,548**	3,137
Medical assistance scheme for the retired employees of NSB				
Fixed deposits	**61,619**	101,405	**61,619**	101,405
Securities purchased under resale agreements	**10,075**	8,253	**10,075**	8,253
Widows'/Widowers' and Orphans Pension Fund				
Fixed deposits	**24,147**	19,763	**24,147**	19,763
Securities purchased under resale agreements	**11,100**	5,078	**11,100**	5,078

Income Statement transactions which were taken place between the Bank and post-employment benefit plans of the Bank as at the year end are summarised below:

For the year ended 31 December	Bank 2018 Rs. '000	Bank 2017 Rs. '000	Group 2018 Rs. '000	Group 2017 Rs. '000
Interest Income				
National Savings Bank Employees' Provident Fund	**27,468**	8,508	**27,468**	8,508
National Savings Bank Employees' Pension Scheme I	**13,628**	29,084	**13,628**	29,084
National Savings Bank Employees' Pension Scheme II	**62**	–	**62**	–
Medical assistance scheme for the retired employees of NSB	**44**	–	**44**	–
Interest Expenses				
National Savings Bank Employees' Provident Fund	**17,426**	47,514	**17,426**	47,514
National Savings Bank Employees' Pension Scheme I	**232,218**	265,482	**232,218**	265,482
National Savings Bank Employees' Pension Scheme II	**10,129**	8,290	**10,129**	8,290
Medical assistance scheme for the retired employees of NSB	**5,210**	8,429	**5,210**	8,429
Widow'/Widowers' and Orphans Pension Fund	**1,011**	1,864	**1,011**	1,864

47. Related party disclosures (contd.)

47. (d) Transactions with key managerial persons

(i) Key managerial persons include members of the Board of Directors of the Bank and key employees of the Bank holding directorships in subsidiary, NSB Fund Management Company Ltd.

(ii) Loans and advances in the names of key managerial persons are given below:

	Bank	
As at 31 December	**2018 Rs. '000**	2017 Rs. '000
Loans and advances	**80,358**	82,294

(iii) Chairman's, Directors', GM/CEO's and DGM's emoluments and fees amounted to Rs. 94.84 Mn. in 2018. (Rs. 69.11 Mn. in 2017).

47. (e) Net accommodation granted to related parties

(Disclosure under Rule 3 (8) (ii) (e) of the Governance Direction of No. 12 of 2007 issued by the Central Bank of Sri Lanka).

	Bank and Group	
As at 31 December	**2018 Rs. '000**	2017 Rs. '000
Key Managerial Persons		
Loan and advances	**80,358**	82,294
Total net accommodation	**80,358**	82,294
Regulatory capital	**36,859,411**	32,808,403
Net accommodation as a percentage of the Bank's regulatory capital (%)	**0.2**	0.3

47. (f) Due from other related parties

	Bank		Group	
As at 31 December	**2018 Rs. '000**	2017 Rs. '000	**2018 Rs. '000**	2017 Rs. '000
Securities purchased under resale agreements – Entrust Securities PLC	**38,910**	31,300	**38,910**	31,300
Receivable from Entrust Securities PLC	**153,596**	96,068	**153,596**	96,068
Total	**192,506**	127,368	**192,506**	127,368

47. Related party disclosures (contd.)

47. (g) Due to other related parties

As at 31 December	Bank		Group	
	2018 Rs. '000	2017 Rs. '000	**2018 Rs. '000**	2017 Rs. '000
Other Payable – Entrust Securities PLC	**716,608**	633,133	**716,608**	633,133
Securities sold under repurchase agreements – Entrust Securities PLC	–	–	**208,790**	142,824
Total	**716,608**	633,133	**925,398**	775,957

48 — Net assets value per ordinary share

As at 31 December	Bank		Group	
	2018 Rs. '000	2017 Rs. '000	**2018 Rs. '000**	2017 Rs. '000
Amount used as the numerator Shareholders' funds	**43,732,665**	39,095,691	**44,755,484**	40,140,278
Number of ordinary share used as the denominator Total number of shares	**940,000**	**670,000**	**940,000**	**670,000**
Net assets value per ordinary share (Rs.)	**46.52**	58.35	**47.61**	59.91

49 — Litigation against the Bank and the Group

Litigation is a common occurrence in the banking industry due to the nature of the business. The Bank has an established protocol for dealing with such legal claims. Once professional advice has been obtained on the certainty of the outcome and the amount of damages reasonably estimated, the Bank makes adjustments to account for any adverse effects which the claims may have on its financial standing. The unresolved court cases against the Bank as at the year end for which adjustments to the Financial Statements have not been made due to the uncertainty of its outcome are as follows.

As at 31 December	Bank	
	2018 Number	2017 Number
Tribunal/Court		
Labour Tribunal	**11**	5
Labour Commission	**0**	0
Industrial Court	**2**	0
Magistrate's Court	**4**	4
District Court	**53**	30
High Court/Civil Appellate High Court/Provincial High Court	**3**	4
Court of Appeal	**5**	6
Supreme Court	**1**	1

50 — Events occurring after the reporting date

Accounting policy

Events occurring after the reporting date are those events, both favourable and unfavourable, that occur between the Reporting date and the date when the Financial Statements are authorised for issue.

Where necessary all material events after the reporting date have been considered and appropriate adjustments/disclosures have been made in the Financial Statements as per the LKAS 10 – "Events after the Reporting Period".

No circumstances have arisen since the reporting date which would require adjustments to or disclosure in the Financial Statements other than the followings:

Merger with Sri Lanka Savings Bank

In 2016 Budget proposals, Hon Minister of Finance has proposed that National Savings Bank to be merged with Sri Lanka Savings Bank and the Bank is in the process of evaluating the proposal as at the reporting date.

51 — Comparative figures

The comparative information is restated wherever necessary, to comply with the SLFRS 9 – "Financial Instrument" and Central Bank format issued.

52 — Explanation of Transition to Sri Lanka Financial Reporting Standard (SLFRS 9)

The following notes set out the impact of adopting Sri Lanka Accounting Standard – SLFRS 9 ("Financial Instruments") at transition date, and the comparable figure for the year 2017 have been restated. The impact of adopting the SLFRS 9 i.e., ("Fist Day impact"), the effect of replacing incurred credit loss calculation under Sri Lanka Accounting Standard – LKAS 39, with expected credit loss calculation under SLFRS 9, has been adjusted to retain earnings (Shareholder's equity).

Reclasification

These adjustments reflect the movement of balances between categories on the Statement of Financial Position and with no impact to shareholders' equity. There is no change to the carrying value of the balances as a result of the reclasificastion.

Remeasurement

These adjustments, which include expected credit loss, result in a change to the carrying value of the item on the Statement of Financial Position with an impact to shareholders' equity.

52. Explanation of Transition to Sri Lanka Financial Reporting Standard (SLFRS 9) (contd.)

52.1 Reconciliation of Income Statements

For the year ended 31 December	Explanatory note	Bank 2017 Rs. '000	Bank Reclassification	Bank Remeasurement	Bank Restated 2017 Rs. '000	Group 2017 Rs. '000	Group Reclassification	Group Remeasurement	Group Restated 2017 Rs. '000
Income	A	107,816,909	–	178,876	107,995,784	108,055,746	–	178,876	108,234,622
Interest income		103,399,962	–	178,876	103,578,838	104,245,541	–	178,876	104,424,417
Interest expenses		78,444,825	–	–	78,444,825	78,987,596	–	–	78,987,596
Net interest income		24,955,137	–	–	25,134,013	25,257,944	–	–	25,436,821
Fee and commission income		782,776	–	–	782,776	785,077	–	–	785,077
Fee and commission expenses		109,082	–	–	109,082	113,037	–	–	113,037
Net fee and commission income		673,694	–	–	673,694	672,040	–	–	672,040
Net gain/(loss) from trading		1,206,408	–	–	1,206,408	1,520,740	–	–	1,520,740
Net fair value gains/(losses) from financial instruments at fair value through profit or loss		–	–	–	–	–	–	–	–
Net gain/(loss) from financial investments	C	707,491	(707,491)	–	–	707,491	(707,491)	–	–
Net gain/(loss) from financial instruments at fair value through profit or loss		–	–	–	–	–	–	–	–
Net gain/(loss) on derecognition of financial assets measured at amortised cost		–	–	–	–	–	–	–	–
Net gains/(losses) from derecognition of financial assets	C	–	707,491	–	707,491	–	707,491		707,491
Other operating income (net)		1,720,272	–	–	1,720,272	796,897	–	–	796,897
Total operating income		29,263,002	–	–	29,441,878	28,955,112	–	–	29,133,988
Impairment Charges	B	693,233	–	72,614	765,847	693,233	–	72,625	765,858
Net operating income		28,569,769	–	–	28,676,030	28,261,880	–	–	28,368,130
Personnel expenses		6,886,505	–	–	6,886,505	6,918,813	–	–	6,918,813
Depreciation and amortisation	C	–	423,547	–	423,547	–	424,352	–	424,352
Other expenses	C	4,160,911	(423,547)	–	3,737,364	4,107,116	(424,352)	–	3,682,765
Operating profit/(loss) before Value Added Tax (VAT) and Nation Building Tax (NBT)		17,522,354	–	–	17,628,615	17,235,951	–	–	17,342,200
Value Added Tax on financial services		3,082,619	–	–	3,082,619	3,168,299	–	–	3,168,299
Nation Building Tax on financial services		411,016	–	–	411,016	422,440	–	–	422,440
Operating profit/(loss) after Value Added Tax (VAT) and Nation Building Tax (NBT)		14,028,719	–	–	14,134,980	13,645,212	–	–	13,751,461
Share of profits of associates and joint ventures		–	–	–	–	–	–	–	–
Profit/(loss) before tax		14,028,719	–	–	14,134,980	13,645,212	–	–	13,751,461
Income tax expenses		4,419,019	–	–	4,419,019	4,595,065	–	–	4,595,065
Profit/(loss) for the period		9,609,700	–	–	9,715,961	9,050,147	–	–	9,156,396
Profit attributable to:									
Equity holders of the Bank		9,609,700	–	–	9,715,961	9,050,147	–	–	9,156,396
Non-controlling interests		–	–	–	–	–	–	–	–
Earnings per share on profit									
Earnings per ordinary share – Basic (Rs.)		15.50	–	–	15.67	14.60	–	–	14.77
Earnings per ordinary share – Diluted (Rs.)		15.50	–	–	15.67	14.60	–	–	14.77
Profit for the period		9,609,700	–	–	9,715,961	9,050,147	–	–	9,156,396

52. Explanation of Transition to Sri Lanka Financial Reporting Standard (SLFRS 9) (contd.)

52.1 Reconciliation of Income Statements (contd.)

		Bank				Group			
			Reclassification	Remeasurement	Restated		Reclassification	Remeasurement	Restated
For the year ended 31 December	Explanatory note	2017 Rs. '000			2017 Rs. '000	2017 Rs. '000			2017 Rs. '000
Profit for the period		9,609,700	–	–	9,715,961	9,050,147	–	–	9,156,396
Other comprehensive income, net of taxes									
Other comprehensive income to be reclassified to Income Statement									
Net gains/(losses) on cash flow hedges	C	290,074	–	–	290,074	290,074	–	–	290,074
Debt instrument at fair value through other comprehensive income		–	693,559	–	693,559	–	858,802	–	858,802
Fair Value gains transferred to the income statement on disposal of Debt instrument at fair value through other comprehensive income	C	–	(690,388)	–	(690,388)	–	(690,388)	–	(690,388)
Gains/(losses) on remeasuring available-for-sale financial assets	C	656,807	(656,807)	–	–	822,050	(822,050)	–	–
Net gains/(losses) on investments in debt instruments measured at fair value through other comprehensive income		–	–	–	–	–	–	–	–
Fair Value gains transferred to the income statement on disposal of available-for-sale financial assets	C	(690,388)	690,388	–	–	(690,388)	690,388	–	–
Total other comprehensive income to be reclassified to income statement	D	256,492	36,752	–	293,245	421,735	36,752	–	458,488
Other comprehensive income not to be reclassified to Income Statement									
Changes in revaluation surplus		4,508,480	–	–	4,508,480	4,508,480		–	4,508,480
Change in fair value on investments in equity instruments designated at fair value through other comprehensive income		–	(36,752)	–	(36,752)	–	(36,752)	–	(36,752)
Remeasurement of post-employment benefit obligations		(2,072,425)	–	–	(2,072,425)	(2,072,155)	–	–	(2,072,155)
Total other comprehensive income not to be reclassified to income statement		2,436,055	(36,752)	–	2,399,303	2,436,325	(36,752)	–	2,399,573
Other comprehensive income for the period, net of taxes		2,692,547	–	–	2,692,547	2,858,060	–	–	2,858,060
Total comprehensive income for the period		12,302,247	–	–	12,408,508	11,908,207	–	–	12,014,456
Attributable to:				–			–	–	–
Equity holders		12,302,247	–	–	12,408,508	11,908,207	–	–	12,014,456

Explanatory note

A: With the adoption of SLFRS 9, the interest income recognised on impaired loan under LKAS 39 has been revised.

B: As adoption of SLFRS 9, incurred credit loss under LKAS 39 replace with expected credit loss.

C: Due to the change in the name of line item of the income statement.

D: The fair value change in equity instrument classified on AFS under LKAS 39, need to be reclassified under item that will not be reclassified to income statement upon the derecognision in SLFRS 9.

52. Explanation of Transition to Sri Lanka Financial Reporting Standard (SLFRS 9) (contd.)

52.2 Reconciliation of financial position – 2017

As at 31 December	Note	Explanatory note	LKAS 39 Category	2017 Audited Rs. '000	Reclassification	Remeasurement	2017 Restated Rs. '000	SLFRS 9 Category
		Bank						
Assets								
Cash and cash equivalents	16	E	L & R	3,849,627	–	(97)	3,849,530	AC
Balances with central banks	17		L & R	–	–	–	–	–
Placements with banks	18	F	L & R	23,438,104	–	(830)	23,437,274	AC
Derivative financial instruments	19		Hedging	1,360,714	–	–	1,360,714	FVOCI
Other Financial assets held for trading			HFT	6,472,314	(6,472,314)	–	–	
Financial assets recognised through profit or loss	20							
– measured at fair value				–	6,472,314	–	6,472,314	FVPL
– designated at fair value				–	–	–	–	
Loans and receivables to banks			L & R	27,714,565	(27,714,565)	–	–	
Loans and receivables to other customers			L & R	360,309,866	(360,309,866)	–	–	
Financial assets at amortised cost								
– loans and advances	21	G		–	376,557,423	(853,693)	375,703,730	AC
– debt and other instruments	22	H		–	555,740,085	(271,467)	555,468,618	AC
Financial assets measured at fair value through other comprehensive income	23	I		–	5,693,829	–	5,693,829	FVOCI
Financial investments – Available for sale			AFS	5,693,829	(5,693,829)	–	–	
Financial investments – Held to maturity			HTM	544,273,077	(544,273,077)	–	–	
Investments in subsidiaries	24		n/a	900,000	–	–	900,000	n/a
Property, plant and equipment	26	J	n/a	12,015,376	380,308	–	12,395,684	n/a
Intangible assets			n/a	380,308	(380,308)	–	–	
Deferred tax assets				–	–	–	–	
Other assets	30		n/a	25,695,689	–	–	25,695,689	n/a
Total assets				1,012,103,470	–	(1,126,087)	1,010,977,382	
Liabilities								
Due to banks	31	K	AC	180,439	48,416,152	–	48,596,591	AC
Derivative financial instruments	32		Hedging	956,937	–	–	956,937	FVOCI
Financial liabilities recognised through profit or loss				–	–	–	–	
Financial liabilities at amortised cost	34			–	–	–	–	
- due to depositors				–	737,212,640	–	737,212,640	AC
- due to debt securities holders				–	–	–	–	
- due to other borrowers		L		–	12,837,008	–	12,837,008	AC
Due to other customers			AC	737,212,640	(737,212,640)	–	–	
Other borrowings			AC	217,955,777	(217,955,777)	–	–	
Debt securities issued	35	M		–	162,709,027	–	162,709,027	AC
Retirement benefit obligation	36			–	3,711,431		3,711,431	n/a
Current tax liabilities				–	–	–	–	
Deferred tax liabilities	29		n/a	507,063	–	–	507,063	n/a
Other liabilities	39	N	n/a	9,062,425	(3,712,181)	–	5,350,244	n/a
Subordinated liabilities			n/a	6,006,411	(6,006,411)	–	–	
Due to subsidiaries	40			–	750	–	750	n/a
Total liabilities				971,881,691	–	–	971,881,691	

52. Explanation of Transition to Sri Lanka Financial Reporting Standard (SLFRS 9) (contd.)

52.2 Reconciliation of financial position – 2017

As at 31 December	Note	Bank Explanatory note	LKAS 39 Category	2017 Audited Rs. '000	Reclassification	Remeasurement	2017 Restated Rs. '000	SLFRS 9 Category
Equity								
Stated capital/assigned capital	41		n/a	6,700,000	–	–	6,700,000	n/a
Statutory reserve fund	42		n/a	3,002,952	–	–	3,002,952	n/a
Retained earnings	43		n/a	2,228,885	–	(1,126,087)	1,102,798	n/a
Other reserves	44		n/a	28,289,941	–	–	28,289,941	n/a
Total shareholders' equity				40,221,778	–	(1,126,087)	39,095,691	
Total equity				40,221,778	–	(1,126,087)	39,095,691	
Total equity and liabilities				1,012,103,470	–	(1,126,087)	1,010,977,382	

As at 31 December	Note	Group Explanatory note	LKAS 39 Category	2017 Audited Rs. '000	Reclassification	Remeasurement	2017 Restated Rs. '000	SLFRS 09 Category
Assets								
Cash and cash equivalents	16	E	L & R	3,854,086	–	(97)	3,853,989	AC
Balances with central banks	17		L & R	94	–	–	94	–
Placements with banks	18	F	L & R	23,438,104	–	(830)	23,437,274	AC
Derivative financial instruments	19		Hedging	1,360,714	–	–	1,360,714	FVOCI
Other Financial assets held for trading			HFT	9,389,950	(9,389,950)	–	–	
Financial assets recognised through profit or loss	20							
– measured at fair value				–	9,389,950	–	9,389,950	FVPL
– designated at fair value				–	–	–	–	
Loans and receivables to banks			L & R	27,971,234	(27,971,234)	–	–	
Loans and receivables to other customers			L & R	358,766,093	(358,766,093)	–	–	
Financial assets at amortised cost								
– loans and advances	21	G		–	375,270,319	(853,693)	374,416,626	AC
– debt and other instruments	22	H		–	559,591,319	(271,567)	559,319,752	AC
Financial assets measured at fair value through other comprehensive income	23	I		–	7,513,932	–	7,513,932	FVOCI
Financial investments – Available for sale			AFS	7,713,852	(7,713,852)	–	–	
Financial investments – Held to maturity			HTM	547,924,390	(547,924,390)	–	–	
Investments in subsidiaries	24		n/a	–	–	–	–	n/a
Property, plant and equipment	26	J	n/a	12,018,679	380,655	–	12,399,334	n/a
Intangible assets			n/a	380,655	(380,655)	–	–	
Deferred tax assets				–	–	–	–	
Other assets	30		n/a	25,976,944	–	–	25,976,944	n/a
Total assets				1,018,794,797	–	(1,126,186)	1,017,668,610	

52. Explanation of Transition to Sri Lanka Financial Reporting Standard (SLFRS 9) (contd.)

52.2 Reconciliation of financial position – 2017

		Group						
As at 31 December	Note	Explanatory note	LKAS 39 Category	2017 Audited Rs. '000	Reclassification	Remeasurement	2017 Restated Rs. '000	SLFRS 9 Category
Liabilities								
Due to banks	31	K	AC	828,433	48,524,141	–	49,352,574	AC
Derivative financial instruments	32		Hedging	956,937	–	–	956,937	FVOCI
Financial liabilities recognised through profit or loss				–	–	–	–	
Financial liabilities at amortised cost	34					–		
– due to depositors				–	737,212,640	–	737,212,640	AC
– due to debt securities holders				–	–	–	–	
– due to other borrowers		L		–	17,545,212	–	17,545,212	AC
Due to other customers			AC	737,212,640	(737,212,640)	–	–	
Other borrowings			AC	222,771,969	(222,771,969)	–	–	
Debt securities issued	35	M		–	162,709,027	–	162,709,027	AC
Retirement benefit obligation	36			–	3,712,665		3,712,665	n/a
Current tax liabilities				137,344	–	–	137,344	
Deferred tax liabilities	29		n/a	507,138	–	–	507,138	n/a
Other liabilities	39	N	n/a	9,107,460	(3,712,665)	–	5,394,795	n/a
Subordinated liabilities			n/a	6,006,411	(6,006,411)	–	–	
Due to subsidiaries	40			–	–	–	–	n/a
Total liabilities				977,528,331	–	–	977,528,332	
Equity								
Stated capital/assigned capital	41		n/a	6,700,000	–	–	6,700,000	n/a
Statutory reserve fund	42		n/a	3,002,952	–	–	3,002,952	n/a
Retained earnings	43		n/a	2,805,727	–	(1,126,086)	1,679,540	n/a
Other reserves	44		n/a	28,757,786	–	–	28,757,786	n/a
Total shareholders' equity				41,266,465	–	(1,126,186)	40,140,278	
Total equity				41,266,465	–	(1,126,186)	40,140,278	
Total equity and liabilities				1,018,794,797	–	(1,126,186)	1,017,668,610	

L&R – Loans and Receivables, **HFT** – Held for Trading, **AFS** – Available for Sale, **HTM** – Held to Maturity, **FVPL** – Fair Value through Profit or Loss, **FVOCI** – Fair Value through Other comprehensive income, **n/a** – Not Applicable

52. Explanation of Transition to Sri Lanka Financial Reporting Standard (SLFRS 9) (contd.)

52.3 Reconciliation of financial position – 2016

	Bank						
As at 31 December	Explanatory note	LKAS 39 Category	2016 Audited Rs. '000	Reclassification	Remeasurement	2016 Restated Rs. '000	SLFRS 9 Category
Assets							
Cash and cash equivalents	E	L & R	4,619,699	–	(125)	4,619,574	AC
Balances with central banks		L & R	–	–	–	–	
Placements with banks	F	L & R	19,013,572	–	(361)	19,013,211	AC
Derivative financial instruments		Hedging	2,728,445	–	–	2,728,445	FVOCI
Other Financial assets held for trading		HFT	20,290,588	(20,290,588)	–	–	
Financial assets recognised through profit or loss							
– measured at fair value			–	20,290,588	–	20,290,588	FVPL
– designated at fair value			–	–	–	–	
Loans and receivables to banks		L & R	31,834,072	(31,834,072)	–	–	
Loans and receivables to other customers		L & R	291,976,942	(291,976,942)	–	–	
Financial assets at amortised cost							
– loans and advances	G		–	312,539,632	(970,044)	311,569,588	AC
– debt and other instruments	H		–	517,095,780	(261,818)	516,833,962	AC
Financial assets measured at fair value through other comprehensive income	I		–	6,227,764	–	6,227,764	FVOCI
Financial investments – Available for sale		AFS	6,227,764	(6,227,764)	–	–	
Financial investments – Held to maturity		HTM	505,824,398	(505,824,398)	–	–	
Investments in subsidiaries		n/a	150,000	–	–	150,000	n/a
Investments in associates and joint ventures						–	
Property, plant and equipment	J	n/a	7,119,651	157,271	–	7,276,922	n/a
Investment properties						–	
Intangible assets		n/a	157,271	(157,271)	–	–	
Deferred tax assets			–	–	–	–	
Other assets		n/a	21,761,440	–	–	21,761,440	n/a
Total assets			911,703,842	–	(1,232,348)	910,471,495	

52. Explanation of Transition to Sri Lanka Financial Reporting Standard (SLFRS 9) (contd.)

52.3 Reconciliation of financial position – 2016 (contd.)

	Bank						
As at 31 December	Explanatory note	LKAS 39 Category	2016 Audited Rs. '000	Reclassification	Remeasurement	2016 Restated Rs. '000	SLFRS 9 Category
Liabilities							
Due to banks	K	AC	115,391	19,631,900	–	19,747,292	AC
Derivative financial instruments		Hedging	–	–	–	–	FVOCI
Other financial liabilities held-for-trading					–	–	
Financial liabilities recognised through profit or loss			–	–	–	–	
Financial liabilities at amortised cost							
– due to depositors			–	657,280,315	–	657,280,315	AC
– due to debt securities holders			–	–	–	–	
– due to other borrowers	L		–	34,479,828	–	34,479,828	AC
Due to other customers		AC	657,280,315	(657,280,315)	–	–	
Other borrowings		AC	207,039,909	(207,039,909)	–	–	
Debt securities issued	M		–	158,934,592	–	158,934,592	AC
Retirement benefit obligation			–	1,896,930	–	1,896,930	n/a
Current tax liabilities				–	–	–	
Deferred tax liabilities		n/a	416,180	–	–	416,180	n/a
Subordinated term debts			–	–	–	–	
Other liabilities	N	n/a	8,600,056	(1,896,930)	–	6,703,126	n/a
Subordinated liabilities		n/a	6,006,411	(6,006,411)	–	–	
Due to subsidiaries			–	–	–	–	n/a
Total liabilities			879,458,262	–	–	879,458,263	
Equity							
Stated capital/assigned capital		n/a	6,200,000	–	–	6,200,000	n/a
Statutory reserve fund		n/a	2,522,467	–	–	2,522,467	n/a
Retained earnings		n/a	2,379,307	–	(1,232,348)	1,146,959	n/a
Other reserves		n/a	21,143,806	–	–	21,143,806	n/a
Total shareholders' equity			32,245,580	–	(1,232,348)	31,013,232	
Total equity			32,245,580	–	(1,232,348)	31,013,232	
Total equity and liabilities			911,703,842	–	(1,232,348)	910,471,495	

52. Explanation of Transition to Sri Lanka Financial Reporting Standard (SLFRS 9) (contd.)

52.3 Reconciliation of financial position – 2016 (contd.)

	Group						
As at 31 December	Explanatory note	LKAS 39 Category	2016 Audited Rs. '000	Reclassification	Remeasurement	2016 Restated Rs. '000	SLFRS 9 Category
Assets							
Cash and cash equivalents	E	L & R	4,627,629	–	(125)	4,627,504	AC
Balances with central banks		L & R	477	–	–	477	
Placements with banks	F	L & R	19,013,572	–	(361)	19,013,211	AC
Derivative financial instruments		Hedging	2,728,445	–	–	2,728,445	FVOCI
Other Financial assets held for trading		HFT	27,303,207	(27,303,207)	–	–	
Financial assets recognised through profit or loss						–	
– measured at fair value			–	27,303,207	–	27,303,207	FVPL
– designated at fair value			–	–	–	–	
Loans and receivables to banks		L & R	31,834,072	(31,834,072)	–	–	
Loans and receivables to other customers		L & R	291,178,121	(291,178,121)	–	–	
Financial assets at amortised cost							
– loans and advances	G		–	311,740,811	(970,044)	310,770,767	AC
– debt and other instruments	H		–	519,096,175	(261,907)	518,834,268	AC
Financial assets measured at fair value through other comprehensive income	I		–	7,922,677	–	7,922,677	FVOCI
Financial investments – Available for sale		AFS	8,122,516	(8,122,516)	–	–	
Financial investments – Held to maturity		HTM	507,624,954	(507,624,954)	–	–	
Investments in subsidiaries		n/a	–	–	–	–	n/a
Investments in associates and joint ventures			–	–	–	–	n/a
Property, plant and equipment	J	n/a	7,121,823	157,271	–	–	n/a
Investment properties			–	–	–	–	n/a
Intangible assets		n/a	157,271	(157,271)	–	7,279,094	n/a
Deferred tax assets		n/a	588	–	–	588	n/a
Other assets		n/a	21,890,777	–	–	21,890,777	n/a
Total assets			921,603,453	–	(1,232,437)	920,371,017	

52. Explanation of Transition to Sri Lanka Financial Reporting Standard (SLFRS 9) (contd.)

52.3 Reconciliation of financial position – 2016 (contd.)

As at 31 December	Group						
	Explanatory note	LKAS 39 Category	2016 Audited Rs. '000	Reclassification	Remeasurement	2016 Restated Rs. '000	SLFRS 9 Category
Liabilities							
Due to banks	K	AC	2,858,673	19,631,900	–	22,490,574	AC
Derivative financial instruments		Hedging	–	–	–	–	FVOCI
Other financial liabilities held-for-trading						–	
Financial liabilities recognised through profit or loss			–	–	–	–	
Financial liabilities at amortised cost			–	–	–	–	
– due to depositors			–	657,280,315	–	657,280,315	AC
– due to debt securities holders			–	–	–	–	
– due to other borrowers	L		–	40,069,345	–	40,069,345	AC
Due to other customers		AC	657,280,315	(657,280,315)	–	–	
Other borrowings		AC	212,629,427	(212,629,427)	–	–	
Debt securities issued	M		–	158,934,592	–	158,934,592	AC
Retirement benefit obligation			–	1,898,190	–	1,898,190	n/a
Current tax liabilities			17,153	–	–	17,153	
Deferred tax liabilities		n/a	416,180	–	–	416,180	n/a
Subordinated term debts			–	–	–	–	
Other liabilities	N	n/a	8,608,506	(1,898,190)	–	6,710,316	n/a
Subordinated liabilities		n/a	6,006,411	(6,006,411)	–	–	
Due to subsidiaries			–	–	–	–	n/a
Total liabilities			887,816,665	–	–	887,816,666	
Equity							
Stated capital/assigned capital		n/a	6,200,000	–	–	6,200,000	n/a
Statutory reserve fund		n/a	2,522,467	–	–	2,522,467	n/a
Retained earnings		n/a	3,708,614	–	(1,232,437)	2,476,177	n/a
Other reserves		n/a	21,355,707	–	–	21,355,707	n/a
Total shareholders' equity			33,786,788	–	(1,232,437)	32,554,351	
Total equity			33,786,788	–	(1,232,437)	32,554,351	
Total equity and liabilities			921,603,453	–	(1,232,437)	920,371,017	

Explanatory Note

E: Cash and cash equivalents

Cash and cash equivalents is subjected to the expected credit loss provisioning under the SLFRS 9.

F: Placements with banks

Placements with banks is subjected to the expected credit loss provisioning under the SLFRS 9.

G: Financial assets at amortised cost – loans and advances

As at 1 January 2018, financial assets previously classified as loan and receivable to bank/other customers have been reclassified as financial assets at amortised cost – loans and advances. These assets met the "Solely Payments of Principal and Interest" (SPPI) criterion. They were not actively traded and held with the intention to collect cash flows and without the intention to sell.

H: Financial assets at amortised cost – debt and other instruments

As at 1 January 2018, financial assets previously classified as financial investments – Held-to-maturity has been reclassified as financial assets at amortised cost – debt and other instruments. These assets met the "Solely Payments of Principal and Interest" (SPPI) criterion. They were not actively traded and held with the intention to collect cash flows and without the intention to sell.

I: Financial assets measured at fair value through other comprehensive income

Financial assets previously classified under available for sale category have been reclassified as financial assets measured at fair value through other comprehensive income.

J: Property, plant and equipment

The intangible assets represent only the computer software and this has been reclassified under property, plant and equipment which was previously classified under intangible assets.

K: Due to banks

Securities sold under repurchase (repo) agreement – Bank has been reclassified under "due to bank" which was previously classified under other borrowing.

L: Financial liabilities at amortised cost – due to other borrowers

Securities sold under repurchase (repo) agreement has been reclassified under "due to other borrowers" which was previously classified under other borrowing.

M: Debt securities issued

Subordinated liabilities and senior note issued have been reclassified as "Debt securities issued" which were previously classified under subordinated liabilities and other borrowing.

N: Other liabilities

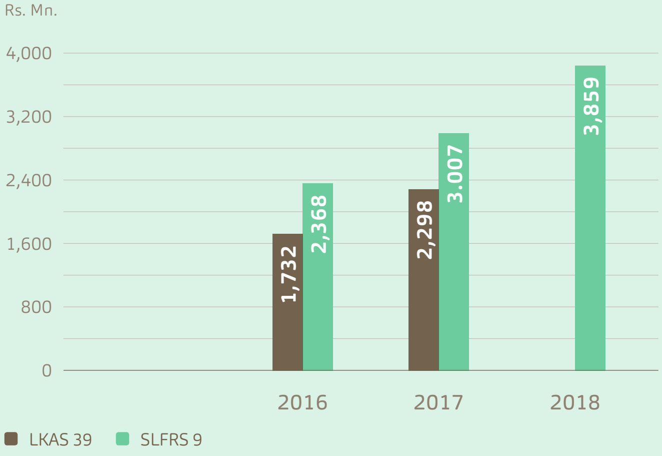
Retirement benefit obligation and due to subsidiary have been separately disclosed on the face of financial position wherever this was previously disclosed under other liabilities.

52. Explanation of Transition to Sri Lanka Financial Reporting Standard (SLFRS 9) (contd.)

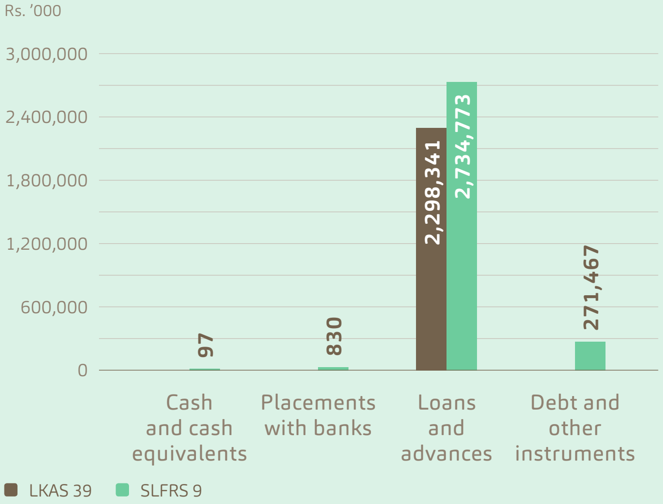
52.4 Reconciliation of impairment allowance – Bank

As at 31 December	2017 Audited Rs. '000	Reclassification Rs. '000	2017 Restated (Except impairment impact) Rs. '000	Impairment provision: As per LKAS 39 Rs. '000	Impairment provision: As per SLFRS 9 Rs. '000	Impairment provision: Net impact on remeasurement Rs. '000	2017 Restated Rs. '000
Assets							
Cash and cash equivalents	3,849,627	–	3,849,627	–	97	97	3,849,530
Balances with central banks	–	–	–	–	–	–	–
Placements with banks	23,438,104	–	23,438,104	–	830	830	23,437,274
Derivative financial instruments	1,360,714	–	1,360,714	–	–	–	1,360,714
Other Financial assets held for trading	6,472,314	(6,472,314)	–	–	–	–	–
Financial assets recognised through profit or loss							
– measured at fair value	–	6,472,314	6,472,314	–	–	–	6,472,314
– designated at fair value	–	–	–	–	–	–	–
Loans and receivables to banks	27,714,565	(27,714,565)	–	–	–	–	–
Loans and receivables to other customers	360,309,866	(360,309,866)	–	–	–	–	–
Financial assets at amortised cost							
– loans and advances	–	376,557,423	376,557,423	2,298,341	2,734,773	436,432	376,120,990
– debt and other instruments	–	555,740,085	555,740,085	–	271,467	271,467	555,468,618
Financial assets measured at fair value through other comprehensive income	–	5,693,829	5,693,829	–	–	–	5,693,829
Financial investments – Available for sale	5,693,829	(5,693,829)	–	–	–	–	–
Financial investments – Held to maturity	544,273,077	(544,273,077)	–	–	–	–	–
	973,112,096	–	**973,112,096**	**2,298,341**	**3,007,167**	**708,826**	**972,403,270**

Impairment provision



Impairment provision – Financial assets 2017 – LKAS 39 vs SLFRS 9



52. Explanation of Transition to Sri Lanka Financial Reporting Standard (SLFRS 9) (contd.)

52.5 The impact on retained earnings by transition to SLFRS 9 is as follows:

	Bank Rs. '000	Group Rs. '000
Closing balance under LKAS 39 as at 31 December 2017	2,228,885	2,805,727
Remeasurement adjustments on adoption of SLFRS 9		
Recognition of SLFRS 9 ECLs for loans and investments (Note 52.6)	(1,126,087)	(1,126,186)
Opening balance under SLFRS 9 as at 1 January 2018	1,102,798	1,679,541

52.6 Day 1 impact on equity

	Bank				
		As per SLFRS 9			
As at 31 December	As per LKAS 39 impairment provision Rs. '000	Impairment provision Rs. '000	Adjustment on accrued interest on impaired loan Rs. '000	Total Rs. '000	**Day 1 impact as at 1 January 2018 Rs. '000**
Cash and cash equivalents	–	97	–	97	**97**
Placements with banks	–	830	–	830	**830**
Financial assets at amortised cost					
– loans and advances	2,298,341	2,734,773	417,260	3,152,034	**853,693**
– debt and other instruments	–	271,467	–	271,467	**271,467**
Total	2,298,341	3,007,167	417,260	3,424,428	**1,126,087**

	Group				
		As per SLFRS 9			
As at 31 December	As per LKAS 39 impairment provision Rs. '000	Impairment provision Rs. '000	Adjustment on accrued interest on impaired loan Rs. '000	Total Rs. '000	**Day 1 impact as at 1 January 2018 Rs. '000**
Cash and cash equivalents	–	97	–	97	**97**
Placements with banks	–	830	–	830	**830**
Financial assets at amortised cost					
– loans and advances	2,298,341	2,734,773	417,260	3,152,034	**853,693**
– debt and other instruments	–	271,566	–	271,566	**271,566**
Total	2,298,341	3,007,266	417,260	3,424,527	**1,126,186**

52. Explanation of Transition to Sri Lanka Financial Reporting Standard (SLFRS 9) (contd.)

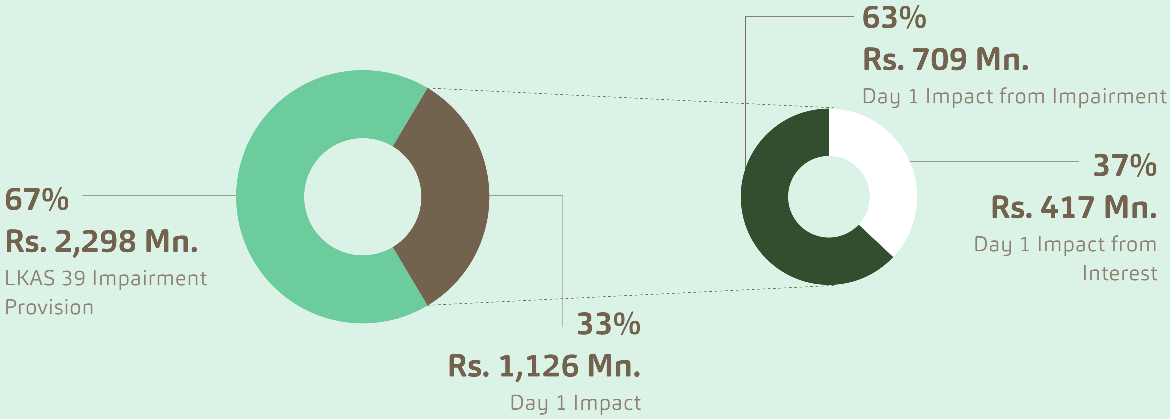
52.6 Day 1 impact on equity (contd.)

Impact on capital adequacy ratio – Bank

As per the Directive No. 4 of 2018 issued by Central Bank of Sri Lanka on "Adoption of Sri Lanka Accounting Standard – SLFRS 9: Financial Instruments", for the purpose of calculating capital adequacy ratio, Banks shall stagger additional credit loss provision arising from SLFRS 9 at the transition date 1 January 2018. Accordingly, Bank has charged only 25% of the 1st Day impact (Rs. 281.5 Mn.) against the Retained Earnings of the Bank for the purpose of calculating capital adequacy ratio as at 31 December 2018. Due to this adjustment, the Tier I capital adequacy ratio and total capital adequacy ratio were decreased by 0.13%.

Composition of SLFRS 9 Impairment provision and accrued interest on impaired loans

Day 1 Impact



53 Financial risk management

Risk management framework

Integrated risk management framework of NSB encompasses policies and procedures covering various risks, mechanism to identify such risks, and effective measures to manage and mitigate risks.

Risk Management Framework of the Bank begins with the oversight of the Board of Directors. It has set-up Board Integrated Risk Management Committee (BIRMC) to assist the Board of Directors in discharging its risk management responsibility. The Risk Management Division (RMD) independently reports to the Board through BIRMC. These Management Committees review regular reports from respective Business Divisions and RMD, to ensure adequacy and effectiveness of Bank's risk management with meticulous focus.

53. Financial risk management (contd.)

Risk management framework (contd.)

The following Management Committees, are responsible for the coordination of risk matters for each of the areas of risk management with meticulous focus:

- Corporate Management Committee
- Asset and Liability Management Committee
- Credit Committee
- Investment Committee
- Performance Review Committee
- Branch Operations Steering Committee
- IT Steering Committee
- Marketing Committee
- Operational Risk Management Committee
- Human Resource Committee
- Corporate Procurement Committee

Internal Audit Division engages both regular and ad hoc reviews of risk management controls and procedures and the results are reported to the Board Audit Committee (BAC).

Broad risk categories in focus

The Bank is exposed to the following key risks from financial instruments:

53.1	**Credit risk**
53.1.1	Credit quality analysis
53.1.1 (a)	Net exposure to credit risk by class of financial assets
53.1.1 (b)	Management of the credit portfolio
53.1.1 (c)	Credit quality (past due) by classes of financial assets
53.1.1 (d)	Credit quality by classes of financial asset – stage-wise
53.2	**Liquidity risk**
53.2.1	Concentration of liquid assets
53.2.2	Remaining contractual period to maturity
53.2.3	Financial assets available to support future funding
53.3	**Market risk**
53.3.1	Market risk – trading and non-trading exposure
53.3.2	Foreign exchange risk
53.3.3	Equity risk
53.3.4	Interest rate risk
53.4	**Operational risk**

53.1 Credit risk

Credit risk is the risk of losses resulting from the failure of a borrower or counterparty to honour its financial or contractual obligations to the Bank which could materialise from the banking book and both on or off-balance sheet. The on-balance sheet credit risk arises mainly from notional value of financial products such as retail loans, corporate loans, loans to banks and financial institutions, loans to State-Owned Enterprises (SOEs) and loans to the Government. The off-balance sheet credit risk arises from undrawn loan commitments.

Credit risk exposures of the Bank

The total credit exposure which is 40.8% of the Bank's total assets is the second major line of business (the investment in risk free securities is 50.6% of total assets). Hence the magnitude of credit risk is comparatively moderate to the Bank, albeit the fact that the Bank considers credit risk as a major type of risk.

The credit exposure of the Bank is created from two main categories i.e., "lending to banks" and "lending to other customers" such as corporate and retail borrowers, Government and Government institutions.

53.1.1 Credit quality analysis

53.1.1 (a) Net exposure to credit risk by class of financial assets

The following tables show the maximum exposure and net exposure (fair value of any collateral held, value of risk-free investments, Government guarantees and impairment provision made were deducted in arriving the net exposure) to credit risk by class of financial assets.

53. Financial risk management (contd.)

53.1 Credit risk (contd.)

53.1.1 Credit quality analysis (contd.)

53.1.1. (a) Net exposure to credit risk by class of financial assets (contd.)

As at 31 December	Note	2018 Maximum exposure to credit risk Rs. '000	2018 Net exposure Rs. '000	2017 Maximum exposure to credit risk Rs. '000	2017 Net exposure Rs. '000
Bank					
Cash and cash equivalents	16	**3,434,524**	**2,735,123**	3,849,530	2,904,771
Balances with central banks	17	–	–	–	–
Placements with banks	18	**17,588,445**	**17,588,445**	23,437,274	23,437,274
Derivative financial instruments	19	**4,740,106**	**4,740,106**	1,360,714	1,360,714
Financial assets recognised through profit or loss	20				
– measured at fair value		**16,680,382**	**1,878,919**	6,472,314	2,357,336
– designated at fair value		–	–	–	–
Financial assets at amortised cost					
– loans and advances	21	**423,532,145**	**159,585,358**	375,703,730	120,925,759
– debt and other instruments	22	**518,947,969**	**12,978,764**	555,468,618	11,461,687
Financial assets measured at fair value through other Comprehensive income	23	**6,184,430**	**3,750,515**	5,693,829	4,440,951
Gross total		**991,108,001**	**203,257,231**	971,986,009	166,888,492

Net exposure to credit risk – Bank

53. Financial risk management (contd.)

53.1 Credit risk (contd.)

53.1.1 Credit quality analysis (contd.)

53.1.1 (a) Net exposure to credit risk by class of financial assets (contd.)

As at 31 December		2018		2017	
	Note	**Maximum exposure to credit risk Rs. '000**	**Net exposure Rs. '000**	Maximum exposure to credit risk Rs. '000	Net exposure Rs. '000
Group					
Cash and cash equivalents	16	**3,436,929**	**2,737,518**	3,853,989	2,909,220
Balances with central banks	17	**177**	**177**	94	94
Placements with banks	18	**17,588,445**	**17,588,445**	23,437,274	23,437,274
Derivative financial instruments	19	**4,740,106**	**4,740,106**	1,360,714	1,360,714
Financial assets recognised through profit or loss	20				
– measured at fair value		**26,867,533**	**1,878,919**	9,389,950	2,357,336
– designated at fair value		**–**	**–**	–	–
Financial assets at amortised cost					
– loans and advances	21	**423,557,119**	**159,585,358**	374,416,626	120,925,759
– debt and other instruments	22	**522,973,159**	**13,329,958**	559,319,752	11,661,509
Financial assets measured at fair value through other Comprehensive income	23	**7,788,560**	**3,751,515**	7,513,932	4,441,951
Gross total		**1,006,952,028**	**203,611,997**	979,292,331	167,093,857

53.1.1 (b) Management of the credit portfolio

Collateral and other credit enhancement

The amount and type of collateral required depends as an assessment of the credit risk of the counterparty. Guidelines are in place covering the accessibility and valuation of each type of collateral.

The main type of collateral obtained are as follows:

a. for corporate lending – Government guarantees, mortgages over immovable and movable fixed assets, inventory, corporate and personal guarantees

b. for retail lending – mortgage over residential property, gold, personal guarantees, vehicles.

53. Financial risk management (contd.)

53.1 Credit risk (contd.)

53.1.1 Credit quality analysis (contd.)

53.1.1 (b) Management of the credit portfolio (contd.)

Concentration of credit risk by product and sector

The Bank monitors the concentration of credit risk by product and sectors. An analysis of concentration risk of the Bank portfolio (Loans and receivables to other customers) is given below:

Concentration by product

As at 31 December	Bank 2018 Rs. '000	Bank 2017 Rs. '000	Group 2018 Rs. '000	Group 2017 Rs. '000
Loans and advances				
Pawning	**30,530,726**	23,874,051	**30,530,726**	23,874,051
Staff loans	**6,103,442**	5,057,767	**6,103,442**	5,057,767
Term loans –				
Short term	**6,080,407**	1,458,560	**6,080,407**	1,458,560
Long term	**380,231,640**	340,380,153	**380,231,640**	340,380,153
Others –				
Sri Lanka Government Securities	–	–	–	–
Loan to Government	**2,075,000**	2,075,000	**2,075,000**	2,075,000
Securities purchased under resale agreement	**2,357,240**	5,592,973	**2,382,213**	4,305,869
Gross total	**427,378,455**	378,438,504	**427,403,428**	377,151,400

Concentration by sector

As at 31 December	Bank 2018 Rs. '000	Bank 2017 Rs. '000	Group 2018 Rs. '000	Group 2017 Rs. '000
Loans and advances				
Agriculture and fishing	**20,817,480**	14,990,754	**20,817,480**	14,990,754
Manufacturing	–	–	–	–
Tourism	**38,746**	49,042	**38,746**	49,042
Transport	**1,356,593**	1,040,305	**1,356,593**	1,040,305
Construction/housing	**116,223,402**	107,478,175	**116,223,402**	107,478,175
Traders	–	–	–	–
New economy	–	–	–	–
Others				
Financial and business services	**26,413,837**	27,452,914	**26,413,837**	27,452,914
Infrastructure	**76,286,787**	76,080,169	**76,286,787**	76,080,169
Power and energy	**6,801,197**	8,525,567	**6,801,197**	8,525,567
Education	**36,362,632**	31,844,099	**36,362,632**	31,844,099
Personal/pawning/other	**143,077,781**	110,977,478	**143,102,754**	109,690,374
Gross total	**427,378,455**	378,438,504	**427,403,428**	377,151,400

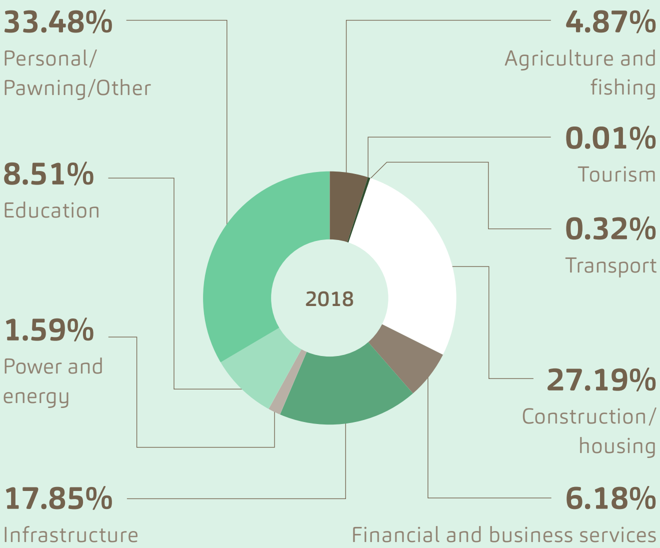
53. Financial risk management (contd.)

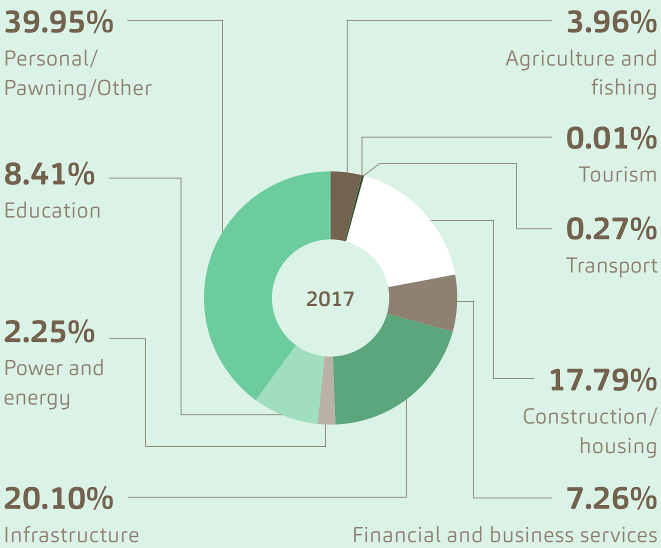
53.1 Credit risk (contd.)

53.1.1 Credit quality analysis (contd.)

53.1.1 (b) Management of the credit portfolio (contd.)

Sector classification of loan and advances – Bank





53.1.1 (c) Credit quality (past due) by classes of financial assets – Bank

As at 31 December 2018	Note	Neither past due nor impaired Rs. '000	Past due but not impaired Rs. '000	Individually impaired Rs. '000	Total Rs. '000
Assets					
Cash and cash equivalents (gross)*	16	3,434,750	–	–	3,434,750
Balances with central banks	17	–	–	–	–
Placements with banks (Gross)*	18	17,591,466	–	–	17,591,466
Derivative financial instruments	19	4,740,106	–	–	4,740,106
Financial assets recognised through profit or loss					
– measured at fair value	20	16,680,382	–	–	16,680,382
– designated at fair value		–	–	–	–
Financial assets at amortised cost					
– loans and advances (gross)*	21	388,425,969	38,952,486	–	427,378,455
– debt and other instruments (gross)*	22	518,957,041	–	–	518,957,041
Financial assets measured at fair value through other Comprehensive income	23	6,184,430	–	–	6,184,430
Total		956,014,144	38,952,486	–	994,966,630

* Collectively assessed for the impairment.

53. Financial risk management (contd.)

53.1 Credit risk (contd.)

53.1.1 Credit quality analysis (contd.)

53.1.1 (c) Credit quality (past due) by classes of financial assets – Bank (contd.)

Aging analysis of past due (i.e., facilities in arrears of 1 day and above) but not impaired loans, by class of financial assets.

As at 31 December 2018	Past due but not impaired				
	1 to 30 days Rs. '000	31 to 60 days Rs. '000	61 to 89 days Rs. '000	More than 90 days Rs. '000	Total Rs. '000
Financial assets at amortised cost – loans and advances (gross)*	**27,606,474**	**4,528,089**	**412,766**	**6,405,157**	**38,952,486**
	71%	**12%**	**1%**	**16%**	**100%**

Facilities in area's of 1 day and above considered as "past due".

As at 31 December 2017	Note	Neither past due nor impaired Rs. '000	Past due but not impaired Rs. '000	Individually impaired Rs. '000	Total Rs. '000
Assets					
Cash and cash equivalents (gross)*	16	3,849,627	–	–	3,849,627
Balances with central banks	17	–	–	–	–
Placements with banks (gross)*	18	23,438,104	–	–	23,438,104
Derivative financial instruments	19	1,360,714	–	–	1,360,714
Financial assets recognised through profit or loss					
– measured at fair value	20	6,472,314	–	–	6,472,314
– designated at fair value		–	–	–	–
Financial assets at amortised cost					
– loans and advances (gross)*	21	348,000,812	30,437,692	–	378,438,504
– debt and other instruments (gross)*	22	555,740,085	–	–	555,740,085
Financial assets measured at fair value through Other comprehensive income	23	5,693,829	–	–	5,693,829
Total		944,555,485	30,437,692	–	974,993,177

* Collectively assessed for the impairment.

Aging analysis of past due (i.e., facilities in arrears of 1 day and above) but not impaired loans, by class of financial assets.

As at 31 December 2017	Past due but not impaired				
	1 to 30 days Rs. '000	31 to 60 days Rs. '000	61 to 90 days Rs. '000	More than 90 days Rs. '000	Total Rs. '000
Financial assets at amortised cost – loans and advances (gross)*	21,234,233	3,656,028	339,814	5,207,617	30,437,692
	70%	12%	1%	17%	100%

Facilities in area's of 1 day and above considered as "past due".

53. Financial risk management (contd.)

53.1 Credit risk (contd.)

53.1.1 Credit quality analysis (contd.)

53.1.1 (d) Credit quality by classes of financial asset – stage wise – Bank

As at 31 December 2018	Note	Amortised cost					Impairment provision				
		Non-credit Impaired Rs. '000	Stage 1 Rs. '000	Stage 2 Rs. '000	Stage 3 Rs. '000	Total Rs. '000	Stage 1 Rs. '000	Stage 2 Rs. '000	Stage 3 Rs. '000	Total Rs. '000	As per financial position Rs. '000
Assets											
Cash and cash equivalents	16	**893,804**	**2,540,946**	–	–	**3,434,750**	**227**	–	–	**227**	**3,434,524**
Balances with central banks	17	–	–	–	–	–	–	–	–	–	–
Placements with banks	18	–	**17,591,466**	–	–	**17,591,466**	**3,021**	–	–	**3,021**	**17,588,445**
Derivative financial instruments	19	**4,740,106**	–	–	–	**4,740,106**	–	–	–	–	**4,740,106**
Financial assets recognised through profit or loss	20										
– measured at fair value		**16,680,382**	–	–	–	**16,680,382**	–	–	–	–	**16,680,382**
– designated at fair value		–	–	–	–	–	–	–	–	–	–
Financial assets at amortised cost											
– loans and advances	21	**28,819,417**	**385,683,843**	**6,470,038**	**6,405,157**	**427,378,454**	**1,610,731**	**272,348**	**1,963,230**	**3,846,310**	**423,532,145**
– debt and other instruments	22	**505,791,978**	**13,165,063**	–	–	**518,957,041**	**9,072**	–	–	**9,072**	**518,947,969**
Financial assets measured at fair value through other comprehensive income	23	**6,184,430**	–	–	–	**6,184,430**	–	–	–	–	**6,184,430**
Total		**563,110,118**	**418,981,317**	**6,470,038**	**6,405,157**	**994,966,630**	**1,623,051**	**272,348**	**1,963,230**	**3,858,630**	**991,108,000**

Credit quality by classes of financial asset – stage wise – Bank

As at 31 December 2017	Note	Amortised cost					Impairment provision				
		Non-credit impaired Rs. '000	Stage 1 Rs. '000	Stage 2 Rs. '000	Stage 3 Rs. '000	Total Rs. '000	Stage 1 Rs. '000	Stage 2 Rs. '000	Stage 3 Rs. '000	Total Rs. '000	As per financial position Rs. '000
Assets											
Cash and cash equivalents	16	1,163,604	2,686,022	–	–	3,849,626	97	–	–	97	3,849,530
Balances with central banks	17	–	–	–	–	–	–	–	–	–	–
Placements with banks	18	–	23,438,104	–	–	23,438,104	830	–	–	830	23,437,274
Derivative financial instruments	19	1,360,714	–	–	–	1,360,714	–	–	–	–	1,360,714
Financial assets recognised through profit or loss	20										
– measured at fair value		6,472,314	–	–	–	6,472,314	–	–	–	–	6,472,314
– designated at fair value		–	–	–	–	–	–	–	–	–	–
Financial assets at amortised cost											
– loans and advances	21	28,589,141	340,653,973	3,988,238	5,207,152	378,438,504	1,127,166	128,432	1,479,175	2,734,773	375,703,730
– debt and other instruments	22	485,116,951	70,623,134	–	–	555,740,085	271,467	–	–	271,467	555,468,618
Financial assets measured at fair value through other comprehensive income	23	5,693,829	–	–	–	5,693,829	–	–	–	–	5,693,829
Total		528,396,553	437,401,233	3,988,238	5,207,152	974,993,176	1,399,560	128,432	1,479,175	3,007,167	971,986,009

Notes to the Financial Statements

53. Financial risk management (contd.)

53.2 Liquidity risk

Liquidity risk is the Bank's inability to meet "on" or "off " balance sheet contractual and contingent financial obligations as they fall due, without incurring material losses.

53.2.1 Concentration of liquid assets

The Bank's regulatory requirement to invest 60% of its deposits in Government Securities forces the Bank to maintain a high statutory liquid assets ratio. Currently, the Bank maintains a liquidity ratio at 54.9% which is well above the statutory requirement of 20%. The investment in Government Securities represents 94.7% from the total liquid assets of the Bank.

	Bank		Group	
As at 31 December	**2018 Rs. '000**	2017 Rs. '000	**2018 Rs. '000**	2017 Rs. '000
Liquidly assets ratio –				
Year end	**54.9**	73.4	–	–
30 June	**71.7**	74.1	–	–
Year beginning	**73.4**	72.6	–	–
Gross loans and advances to deposit	**50.9**	52.9	**50.9**	52.8
Net loans and advances to total assets	**40.8**	38.3	**40.3**	38.0

Liquidity assets and liabilities of the Bank

	Domestic business unit	
	2018 Rs. '000	2017 Rs. '000
Total liquid assets		
Cash	**1,026,726**	1,006,187
Balances with licensed commercial bank	**20,372,364**	26,584,690
Money at call in Sri Lanka	–	643
Treasury bills and securities issued or guaranteed by the Government of Sri Lanka	**25,230,190**	28,055,179
Cash item in the process of collection	**271,129**	277,031
Balances with banks aboard	**685,650**	272,007
Treasury Bonds	**376,736,980**	395,209,012
Sri Lanka development bonds	**167,067**	57,674,658
Total liquid assets (Daily average statutory liquid assets during the month of December)	**424,490,106**	509,079,407
Total liability based subject to minimum liquid assets requirement	**773,498,104**	693,235,258
Liquidity asset ratio (%)	**54.88**	73.44

53.2.2 Remaining contractual period to maturity – Bank and the Group

Disclosures are given in the Note 54 on pages 372 to 374.

53. Financial risk management (contd.)

53.2 Liquidity risk (contd.)

53.2.3 Financial assets available to support future funding

The table below sets out the availability of the bank's financial assets to support future funding:

		Bank					Group				
		Encumbered		**Unencumbered**		**Total ***	**Encumbered**		**Unencumbered**		**Total ***
As at 31 December 2018	Note	**Pledge as collateral Rs. '000**	**Other Rs. '000**	**Available as collateral Rs. '000**	**Other Rs. '000**	**Rs. '000**	**Pledge as collateral Rs. '000**	**Other Rs. '000**	**Available as collateral Rs. '000**	**Other Rs. '000**	**Rs. '000**
Cash and cash equivalents	16	–	–	**3,434,750**	–	**3,434,750**	–	–	**3,437,155**	–	**3,437,155**
Balances with central banks	17	–	–	–	–	–	–	**177**	–		**177**
Placements with banks	18	–	–	**17,591,466**		**17,591,466**	–	–	**17,591,466**	–	**17,591,466**
Derivative financial instruments	19	–	–	–	**4,740,106**	**4,740,106**	–	–	–	**4,740,106**	**4,740,106**
Financial assets recognised through profit or loss	20										
– measured at fair value		–	–	**16,680,382**	–	**16,680,382**	**9,595,990**		**17,271,543**	–	**26,867,533**
– designated at fair value		–	–	–	–	–	–	–	–	–	–
Financial assets at amortised cost											
– loans and advances	21	–	–	**427,378,455**	–	**427,378,455**	–	–	**427,403,428**	–	**427,403,428**
– debt and other instruments	22	**69,160,408**	–	**449,796,633**	–	**518,957,041**	**72,546,833**		**450,435,443**	–	**522,982,276**
Financial assets measured at fair value through other comprehensive income	23	–	–	**6,184,430**	–	**6,184,430**	**1,524,097**	–	**6,264,463**	–	**7,788,560**
Total		**69,160,408**	–	**921,066,116**	**4,740,106**	**994,966,630**	**83,666,920**	**177**	**922,403,498**	**4,740,106**	**1,010,810,702**

		Bank					Group				
		Encumbered		Unencumbered		Total *	Encumbered		Unencumbered		Total *
As at 31 December 2017	Note	Pledge as collateral Rs. '000	Other Rs. '000	Available as collateral Rs. '000	Other Rs. '000	Rs. '000	Pledge as collateral Rs. '000	Other Rs. '000	Available as collateral Rs. '000	Other Rs. '000	Rs. '000
Cash and cash equivalents	16	–	–	3,849,627	–	3,849,627	–	–	3,854,086	–	3,854,086
Balances with central banks	17	–	–	–	–	-	–	94	-		94
Placements with banks	18	–	–	23,438,104		23,438,104	–	–	23,438,104	–	23,438,104
Derivative financial instruments	19	–	–	–	1,360,714	1,360,714	–	–	–	1,360,714	1,360,714
Financial assets recognised through profit or loss	20										
– measured at fair value		–	–	6,472,314	–	6,472,314	2,848,477		6,541,473	–	9,389,950
– designated at fair value		–	–	–	–	–	–	–	–	–	–
Financial assets at amortised cost											
– loans and advances	21	–	–	378,438,504	–	378,438,504	–	–	377,151,400	–	377,151,400
– debt and other instruments	22	48,382,000	–	507,358,085	–	555,740,085	51,689,909		507,901,410	–	559,591,319
Financial assets measured at fair value through other comprehensive income	23	–	–	5,693,829	–	5,693,829	1,690,832	–	5,823,100	–	7,513,932
Total		48,382,000	–	925,250,463	1,360,714	974,993,177	56,229,218	94	924,709,573	1,360,714	982,299,598

* Figures are stated before the impairment provisions.

53. Financial risk management (contd.)

53.3 Market risk

Market risk to the Bank stems from movements in market prices, in particular, changes in interest rates, foreign exchange rates and equity prices. Market risk is often propagated by other forms of financial risk such as credit and market liquidity risk. The risk of losses would arise from on-balance sheet as well as off-balance sheet activities.

Sources of market risk to NSB

The exposure to market risk arises to National Savings Bank from the following sources:

- Treasury securities portfolio (Government Securities and other permitted fixed income securities)
- Repo and reverse repo transaction
- Bank's operations in foreign currency
- Equity investments
- Derivatives
- Rate sensitive assets liabilities mismatch

53.3.1 Market risk – trading and non-trading exposure

Following table present the assets and liabilities subject to market risk between fair value through profit or loss and other than fair value through profit or loss:

As at 31 December 2018	Note	Bank			Group		
		Carrying amount Rs. '000	Amount exposure to trading Rs. '000	Non-trading exposure Rs. '000	Carrying amount Rs. '000	Amount exposure to trading Rs. '000	Non-trading exposure Rs. '000
Assets subject to market risk							
Cash and cash equivalents	16	3,434,524	–	3,434,524	3,436,929	–	3,436,929
Balances with central banks	17	–	–	–	177	–	177
Placements with banks	18	17,588,445	–	17,588,445	17,588,445	–	17,588,445
Derivative financial instruments	19	4,740,106	–	4,740,106	4,740,106	–	4,740,106
Financial assets recognised through profit or loss	20						
– measured at fair value		16,680,382	16,680,382	–	26,867,533	26,867,533	–
– designated at fair value		–	–	–	–	–	–
Financial assets at amortised cost							
– loans and advances	21	423,532,145	–	423,532,145	423,557,119	–	423,557,119
– debt and other instruments	22	518,947,969	–	518,947,969	522,973,159	–	522,973,159
Financial assets measured at fair value through other comprehensive income	23	6,184,430	–	6,184,430	7,788,560	–	7,788,560
Total		991,108,001	16,680,382	974,427,619	1,006,952,028	26,867,533	980,084,495

53. Financial risk management (contd.)

53.3 Market risk (contd.)

53.3.1 Market risk – trading and non-trading exposure (contd.)

As at 31 December 2018	Note	Bank Carrying amount Rs. '000	Bank Amount exposure to trading Rs. '000	Bank Non-trading exposure Rs. '000	Group Carrying amount Rs. '000	Group Amount exposure to trading Rs. '000	Group Non-trading exposure Rs. '000
Liabilities subject to market risk							
Due to banks	31	**77,119,146**	–	**77,119,146**	**83,615,264**	–	**83,615,264**
Derivative financial instruments	32	**1,533**	**1,533**	–	**1,533**	**1,533**	–
Financial liabilities recognised through profit or loss	33	–	–	–	–	–	–
Financial liabilities at amortised cost	34						
– due to depositors		**839,574,411**	–	**839,574,411**	**839,574,411**	–	**839,574,411**
– due to debt securities holders		–	–	–		–	–
– due to other borrowers		**14,804,802**	–	**14,804,802**	**21,750,178**	–	**21,750,178**
Debt securities issued	35	**52,389,133**	–	**52,389,133**	**52,389,133**	–	**52,389,133**
Total		**983,889,024**	**1,533**	**983,887,491**	**997,330,518**	**1,533**	**997,328,986**

As at 31 December 2017	Note	Bank Carrying amount Rs. '000	Bank Amount exposure to trading Rs. '000	Bank Non-trading exposure Rs. '000	Group Carrying amount Rs. '000	Group Amount exposure to trading Rs. '000	Group Non-trading exposure Rs. '000
Assets subject to market risk							
Cash and cash equivalents	16	3,849,530	–	3,849,530	3,853,989	–	3,853,989
Balances with central banks	17	–	–	–	177	–	177
Placements with banks	18	23,437,274	–	23,437,274	23,437,274	–	23,437,274
Derivative financial instruments	19	1,360,714	–	1,360,714	1,360,714	–	1,360,714
Financial assets recognised through profit or loss	20						
– measured at fair value		6,472,314	6,472,314	–	9,389,950	9,389,950	–
– designated at fair value		–	–	–		–	–
Financial assets at amortised cost							
– loans and advances	21	375,703,730	–	375,703,730	374,416,626	–	374,416,626
– debt and other instruments	22	555,468,618	–	555,468,618	559,319,752	–	559,319,752
Financial assets measured at fair value through other comprehensive income	23	5,693,829	–	5,693,829	7,513,932	–	7,513,932
Total		971,986,009	6,472,314	965,513,695	979,292,415	9,389,950	969,902,465

53. Financial risk management (contd.)

53.3 Market risk (contd.)

53.3.1 Market risk – trading and non-trading exposure (contd.)

As at 31 December 2017	Note	Bank			Group		
		Carrying amount Rs. '000	Amount exposure to trading Rs. '000	Non-trading exposure Rs. '000	Carrying amount Rs. '000	Amount exposure to trading Rs. '000	Non-trading exposure Rs. '000
Liabilities subject to market risk							
Due to banks	31	48,596,591	–	48,596,591	49,352,574	–	49,352,574
Derivative financial instruments	32	956,937	–	956,937	956,937	–	956,937
Financial liabilities recognised through profit or loss	33	–	–	–	–	–	–
Financial liabilities at amortised cost	34						–
– due to depositors		737,212,640	–	737,212,640	737,212,640	–	737,212,640
– due to debt securities holders		–	–	–	–	–	–
– due to other borrowers		12,837,008	–	12,837,008	17,545,212	–	17,545,212
Debt securities issued	35	162,709,027	–	162,709,027	162,709,027	–	162,709,027
Total		962,312,204	–	962,312,204	967,776,390	–	967,776,390

53.3.2 Foreign exchange risk

Foreign exchange rate risk arises from the movement of the rate of exchange of one currency against another, leading to an adverse impact on the Bank's earnings or equity. The Bank is exposed to foreign exchange rate risk that the value of a financial instrument or the investment in its foreign assets, may fluctuate due to changes in foreign exchange rates.

An impact analysis of the foreign currency Net Open Position (NOP) was carried out applying shock levels of 5%, 10% and 15%, for depreciation on the current exchange rate and the impact on the currency-wise NOP and the impact on Income Statement is shown in the tables below as at 31 December 2018:

	USD '000	Rs. '000	GBP '000	Rs. '000
Net open position	864	157,818	503	116,581
Stress level	Effect on income statement Rs. '000	Revised rupee position Rs. '000	Effect on income statement Rs. '000	Revised rupee position Rs. '000
Shock of 5% on exchange rate (rupee depreciation)	7,891	165,709	5,829	122,410
Shock of 10% on exchange rate (rupee depreciation)	15,782	173,600	11,658	128,239
Shock of 15% on exchange rate (rupee depreciation)	23,673	181,491	17,487	134,068

	JPY '000	Rs. '000	EUR '000	Rs. '000
Net open position	(165,415)	(272,935)	4,307	900,431
Stress level	Effect on income statement Rs. '000	Revised rupee position Rs. '000	Effect on income statement Rs. '000	Revised rupee position Rs. '000
Shock of 5% on exchange rate (rupee depreciation)	(13,647)	(286,582)	45,022	945,453
Shock of 10% on exchange rate (rupee depreciation)	(27,294)	(300,229)	90,043	990,474
Shock of 15% on exchange rate (rupee depreciation)	(40,940)	(313,875)	135,065	1,035,496

The Bank has entered in to swap and forward foreign exchange contract to minimise the foreign exchange risk (refer Note 19 on pages 293 to 295).

53. Financial risk management (contd.)

53.3 Market risk (contd.)

53.3.3 Equity risk

Equity risk is the risk that one's investments will depreciate because of stock market dynamic causing one to lose money.

The investment in equity represents 0.54% of the total assets while investments in quoted and unquoted equity are 0.5% and 0.04% respectively. Hence, the Bank does not have a major exposure to equity risk. However, the adverse movements in the stock market affected the return on equity investments. The investment in unquoted companies are made due to policy decisions on market and economic development and strategic reasons.

The Bank conducts mark-to-market calculations on a monthly, quarterly and on a need basis to identify the impact due to changes in equity prices.

Equity price shock

The table below summarises the impact (both to the Income Statement and to the equity).

		Bank and Group					
		2018			2017		
	Note	**Financial assets recognised through profit or loss Rs. '000**	**Financial assets measured at FVOCI Rs. '000**	**Total Rs. '000**	Financial assets recognised through profit or loss Rs. '000	Financial assets measured at FVOCI Rs. '000	Total Rs. '000
Market value of equity securities as at 31 December	20 and 22	**1,878,919**	**3,447,888**	**5,326,807**	2,357,336	3,876,570	6,233,907

Stress Level	**Impact to P&L Rs. '000**	**Impact to OCI Rs. '000**	**Impact to equity Rs. '000**	Impact to P&L Rs. '000	Impact to OCI Rs. '000	Impact to equity Rs. '000
Shock of 5% on equity prices (upward)	**93,946**	**172,394**	**266,340**	117,867	193,829	311,695
Shock of 5% on equity prices (downward)	**(93,946)**	**(172,394)**	**(266,340)**	(117,867)	(193,829)	(311,695)
Shock of 10% on equity prices (upward)	**187,892**	**344,789**	**532,681**	235,734	387,657	623,391
Shock of 10% on equity prices (downward)	**(187,892)**	**(344,789)**	**(532,681)**	(235,734)	(387,657)	(623,391)
Shock of 15% on equity prices (upward)	**281,838**	**517,183**	**799,021**	353,600	581,486	935,086
Shock of 15% on equity prices (downward)	**(281,838)**	**(517,183)**	**(799,021)**	(353,600)	(581,486)	(935,086)
Shock of 20% on equity prices (upward)	**375,784**	**689,578**	**1,065,361**	471,467	775,314	1,246,781
Shock of 20% on equity prices (downward)	**(375,784)**	**(689,578)**	**(1,065,361)**	(471,467)	(775,314)	(1,246,781)

53. Financial risk management (contd.)

53.3 Market risk (contd.)

53.3.3 Equity risk (contd.)

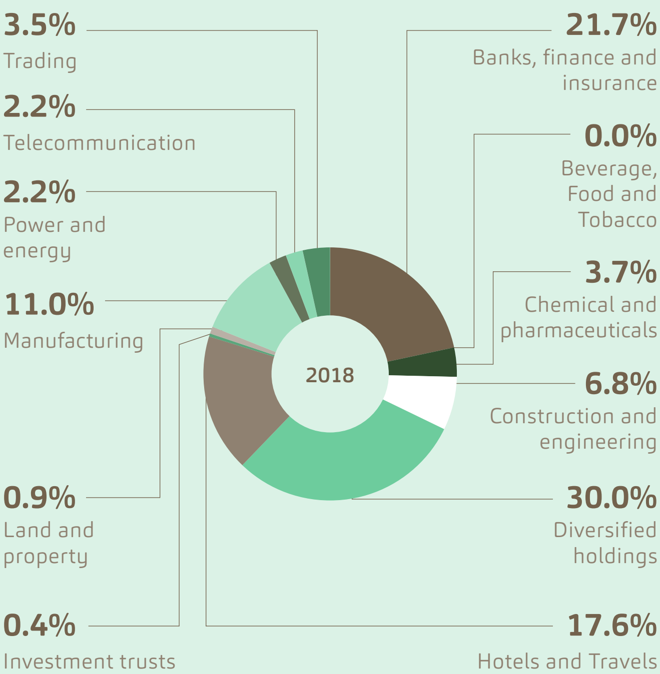
Investment in equity shares by sector

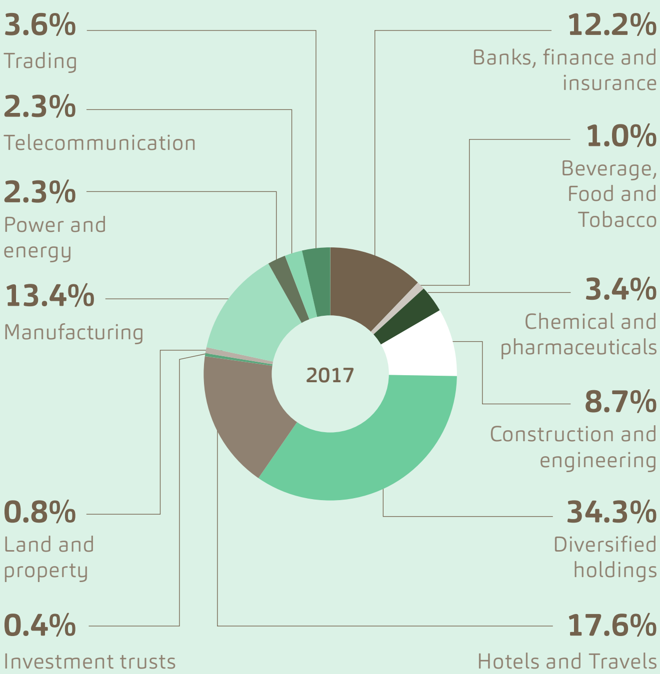
Following table presents the bank diversification of trading portfolio to minimise the risk associate with particular sector:

As at 31 December	2018				2017			
	Cost Rs. '000	As % of total cost %	Market value Rs. '000	As % of total market value %	Cost Rs. '000	As % of total cost %	Market value Rs. '000	As % of total market value %
1. Banks, finance and insurance	**507,640**	**15.5**	**372,564**	**21.7**	336,293	9.8	264,382	12.2
2. Beverage, Food and Tobacco	**–**	**0.0**	**–**	**0.0**	21,003	0.6	22,608	1.0
3. Chemical and pharmaceuticals	**100,527**	**3.1**	**63,927**	**3.7**	100,527	2.9	74,004	3.4
4. Construction and engineering	**408,295**	**12.5**	**117,577**	**6.8**	408,295	11.9	188,168	8.7
5. Diversified holdings	**782,405**	**23.9**	**515,862**	**30.0**	1,032,626	30.1	746,764	34.3
6. Hotels and Travels	**694,592**	**21.2**	**302,858**	**17.6**	745,466	21.8	383,397	17.6
7. Investment trusts	**11,307**	**0.3**	**6,857**	**0.4**	11,307	0.3	8,302	0.4
8. Land and property	**23,777**	**0.7**	**15,567**	**0.9**	23,777	0.7	16,419	0.8
9. Manufacturing	**301,773**	**9.2**	**189,007**	**11.0**	287,345	8.4	293,465	13.4
10. Power and energy	**46,066**	**1.4**	**38,695**	**2.2**	50,719	1.5	49,705	2.3
11. Telecommunication	**81,332**	**2.5**	**37,757**	**2.2**	94,332	2.8	49,105	2.3
12. Trading	**315,149**	**9.6**	**60,085**	**3.5**	315,149	9.2	77,820	3.6
Subtotal	**3,272,863**	**100**	**1,720,756**	**100**	3,426,839	100	2,174,139	100
13. Unit trust	**95,110**	**2.8**	**158,163**	**8.4**	95,110	2.7	183,197	7.8
Total	**3,367,973**		**1,878,919**		3,521,949		2,357,336	

Market value of investment in equity shares by industry – Bank and Group

Trading equity portfolio





53. Financial risk management (contd.)

53.3 Market risk (contd.)

53.3.4 Interest rate risk

Interest rate risk is the risk that an investment's value will change in the absolute level of interest rates, in the spread between two rates, in the shape of the yield curve or in any other interest rate relationships. The Bank's major source of funding is deposits which represent 80.93% of total on balance sheet liabilities. of this, 23.62% represent savings deposits where 76.38% represent term deposits.

53.3.4 (a) Interest rate risk – sensitivity analysis

Bank's interest rate sensitivity report as at 31 December 2018 is presented below:

Bank	0-1 month Rs. '000	0-3 months Rs. '000	0-6 months Rs. '000	0-12 months Rs. '000
Interest-bearing assets	**37,126,827**	**71,149,238**	**104,526,636**	**216,552,684**
Bank balances and placements	749,722	8,975,812	12,068,111	17,601,973
Financial assets recognised through profit or loss – measured at fair value	190,318	526,079	570,635	571,242
Financial assets at amortised cost – loans and advances	14,642,598	24,859,047	41,533,244	101,172,738
– debt and other instruments	21,455,536	36,694,607	50,258,536	97,110,621
Financial assets measured at fair value through Other comprehensive income	88,653	93,693	96,110	96,110
Interest-bearing liabilities	**225,453,233**	**498,851,396**	**659,431,869**	**947,717,986**
Due to banks	53,842,968	58,368,770	61,920,449	65,087,313
Financial liabilities at amortised cost – due to depositors	158,160,107	425,141,386	582,029,005	821,436,738
– due to debt securities holders	–	–	–	–
– due to other borrowers	13,450,158	14,619,083	14,762,981	14,804,802
Debt securities issued	–	722,157	719,434	46,389,133
Net rate sensitive assets (liabilities)	(188,326,406)	(427,702,158)	(554,905,233)	(731,165,302)
Interest rate sensitivity ratio (%)	16	14	16	23

53. Financial risk management (contd.)

53.3 Market risk (contd.)

53.3.4 Interest rate risk (contd.)

53.3.4 (a) Interest rate risk – sensitivity analysis (contd.)

Group's interest rate sensitivity report as at 31 December 2018 is presented below:

Group	0-1 month Rs. '000	0-3 months Rs. '000	0-6 months Rs. '000	0-12 months Rs. '000
Interest-bearing assets	**37,361,505**	**71,853,272**	**105,656,047**	**218,532,850**
Bank balances and placements	749,722	8,975,812	12,068,111	17,601,973
Financial assets recognised through profit or loss – measured at fair value	361,118	1,038,479	1,280,540	1,676,158
Financial assets at amortised cost – loans and advances	14,646,133	24,869,651	41,548,638	101,197,711
– debt and other instruments	21,490,680	36,800,040	50,395,468	97,310,551
Financial assets measured at fair value through other comprehensive income	113,852	169,290	363,290	746,457
Interest-bearing liabilities	**229,031,968**	**509,587,603**	**671,069,838**	**961,159,480**
Due to banks	55,572,529	63,557,454	67,544,944	71,583,431
Financial liabilities at amortised cost – due to depositors	158,160,107	425,141,386	582,029,005	821,436,738
– due to debt securities holders	–	–	–	–
– due to other borrowers	15,299,332	20,166,606	20,776,455	21,750,178
Debt securities issued	–	722,157	719,434	46,389,133
Net rate sensitive assets (liabilities)	(191,670,463)	(437,734,331)	(565,413,791)	(742,626,630)
Interest rate sensitivity ratio (%)	16	14	16	23

Bank's interest rate sensitivity report as at 31 December 2017 is presented below:

Bank	0-1 month Rs. '000	0-3 months Rs. '000	0-6 months Rs. '000	0-12 months Rs. '000
Interest-bearing assets	24,434,435	55,616,881	117,697,502	316,867,302
Bank balances and placements	1,008,750	5,089,145	11,196,173	23,820,037
Financial assets recognised through profit or loss – measured at fair value	1,840	91,793	112,824	243,775
Financial assets at amortised cost – loans and advances	17,102,744	25,264,584	36,102,906	97,562,298
– debt and other instruments	6,321,101	25,170,417	69,112,422	194,068,015
Financial assets measured at fair value through Other comprehensive income	–	942	1,173,177	1,173,177
Interest-bearing liabilities	199,871,593	456,013,831	585,765,770	901,999,449
Due to banks	46,105,764	48,433,041	48,472,056	48,596,591
Financial liabilities at amortised cost – due to depositors	141,589,236	391,222,111	520,951,317	722,143,176
– due to debt securities holders	–	–	–	–
– due to other borrowers	12,176,593	12,793,645	12,803,989	12,837,009
Debt securities issued	–	3,565,034	3,538,408	118,422,673
Net rate sensitive assets (liabilities)	(175,437,158)	(400,396,950)	(468,068,268)	(585,132,147)
Interest rate sensitivity ratio (%)	12	12	20	35

53. Financial risk management (contd.)

53.3 Market risk (contd.)

53.3.4 Interest rate risk (contd.)

53.3.4 (a) Interest rate risk – sensitivity analysis (contd.)

Group's interest rate sensitivity report as at 31 December 2017 is presented below:

Group	0-1 month Rs. '000	0-3 months Rs. '000	0-6 months Rs. '000	0-12 months Rs. '000
Interest-bearing assets	24,543,750	55,944,828	118,614,158	318,961,380
Bank balances and placements	1,008,750	5,089,145	11,196,173	23,820,037
Financial assets recognised through profit or loss – measured at fair value	22,588	154,037	385,623	937,686
Financial assets at amortised cost – loans and advances	17,191,311	25,530,287	36,372,982	97,841,120
– debt and other instruments	6,321,101	25,170,417	69,418,163	194,985,238
Financial assets measured at fair value Through other comprehensive income	–	942	1,241,217	1,377,299
Interest-bearing liabilities	201,837,047	461,910,194	592,040,049	909,029,561
Due to banks	46,754,915	50,380,494	50,544,327	50,918,499
Financial liabilities at amortised cost – due to depositors	141,589,236	391,222,111	520,951,317	722,143,176
– due to debt securities holders	–	–	–	–
– due to other borrowers	13,492,896	16,742,555	17,005,997	17,545,213
Debt securities issued	–	3,565,034	3,538,408	118,422,673
Net rate sensitive assets (liabilities)	(177,293,297)	(405,965,366)	(473,425,891)	(590,068,181)
Interest rate sensitivity ratio (%)	12	12	20	35

53.3.4. (b) Exposure to interest rate risk

The management of interest rate risk against interest rate gap limits is supplemented by monitoring the sensitivity of the Bank's financial assets and financial liabilities to various interest rate scenarios.

The following table demonstrates the sensitivity of the Bank's Income Statement as at the reporting date, due to change in interest rates with all other variables held constant in less than one year maturity bucket.

Sensitivity of projected net interest income

	2018	
Net Interest Income (NII)	Parallel increase Rs. '000	Parallel decrease Rs. '000
Change in 25 bps	(1,267,530)	1,267,530
Change in 50 bps	(2,535,061)	2,535,061
Change in 100 bps	(5,070,121)	5,070,121

Notes to the Financial Statements

53. Financial risk management (contd.)

53.4 Operational risk

The BASEL Committee on Banking Supervision defines operational risk as "the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events".

Operational risk management framework

Bank has a conducive Operational Risk Management (ORM) framework to achieve more efficient, transparent, profitable and sustainable business operations. It comprises with well-structured governance, policy framework and risk management processes. The operational risk of the Bank is reported to the ORMC, BIRMC and the Board by Operational Risk Management Unit of the Risk Management Division.

54 — Maturity analysis

Bank	Up to 3 months Rs. '000	3-12 months Rs. '000	1-3 years Rs. '000	3-5 years Rs. '000	More than 5 years Rs. '000	**Total as at 31.12.2018 Rs. '000**	Total as at 31.12.2017 Rs. '000
Assets with contractual maturity (interest-bearing asset)							
Cash and cash equivalents	13,528	–	–	–	–	**13,528**	382,763
Placements with banks	8,962,285	8,626,160	–	–	–	**17,588,445**	23,437,274
Financial assets recognised through profit or loss							
– measured at fair value	526,079	45,164	1,562,229	5,587,752	7,080,240	**14,801,463**	4,114,978
Financial assets at amortised cost							
– loans and advances	24,859,047	76,313,691	116,389,323	75,402,639	130,567,445	**423,532,145**	375,703,730
– debt and other instruments	36,694,607	60,416,015	100,748,159	124,717,849	196,371,339	**518,947,969**	555,468,618
Financial assets measured at fair value through other comprehensive income	93,693	2,417	574,676	1,614,189	148,939	**2,433,915**	1,252,878
	71,149,238	145,403,447	219,274,387	207,322,429	334,167,963	**977,317,466**	960,360,241
Other assets (non-interest-bearing assets)							
Cash and cash equivalents	3,420,996	–	–	–	–	**3,420,996**	3,466,767
Derivative financial instruments	4,740,106	–	–	–	–	**4,740,106**	1,360,714
Financial assets recognised through profit or loss							
– measured at fair value	469,730	1,409,189	–	–	–	**1,878,919**	2,357,336
Financial assets measured at fair value through other comprehensive income	–	–	–	–	3,750,515	**3,750,515**	4,440,951
Investments in subsidiaries	–	–	–	–	1,700,000	**1,700,000**	900,000
Property, plant and equipment	–	–	–	–	13,465,755	**13,465,755**	12,395,684
Other assets	845,513	9,129,458	8,887,211	6,541,719	5,805,314	**31,209,216**	25,695,689
	9,476,345	10,538,647	8,887,211	6,541,719	24,721,584	**60,165,507**	50,617,141
Total assets	80,625,583	155,942,094	228,161,598	213,864,148	358,889,547	**1,037,482,973**	1,010,977,382

54. Maturity analysis (contd.)

Bank	Up to 3 months Rs. '000	3-12 months Rs. '000	1-3 years Rs. '000	3-5 years Rs. '000	More than 5 years Rs. '000	**Total as at 31.12.2018 Rs. '000**	Total as at 31.12.2017 Rs. '000
Liabilities with contractual maturity (interest-bearing liabilities)							
Due to banks	58,368,770	6,718,543	12,031,832	–	–	**77,119,146**	48,596,591
Financial liabilities at amortised cost							
– due to depositors	425,141,386	396,295,352	13,301,606	4,836,068	–	**839,574,411**	737,212,640
– due to other borrowers	14,619,083	185,718	–	–	–	**14,804,802**	12,837,008
Debt securities issued	–	46,389,133	–	6,000,000	–	**52,389,133**	162,709,027
	498,129,239	449,588,746	25,333,438	10,836,068	–	**983,887,491**	961,355,266
Other liabilities (non-interest-bearing liability)							
Derivative financial instruments	–	–	1,533	–	–	**1,533**	956,937
Retirement benefit obligations	–	–	–	–	3,830,795	**3,830,795**	3,711,431
Deferred tax liabilities	–	–	–	–	582,463	**582,463**	507,063
Other liabilities	2,750,829	875,249	794,715	779,046	247,437	**5,447,277**	5,350,244
Due to subsidiaries	750	–	–	–	–	**750**	750
Stated capital/Assigned capital	–	–	–	–	9,400,000	**9,400,000**	6,700,000
Statutory reserve fund	–	–	–	–	3,227,960	**3,227,960**	3,002,952
Retained earnings	–	–	–	–	4,622,080	**4,622,080**	1,102,798
Other reserves	–	–	–	–	26,482,625	**26,482,625**	28,289,941
	2,751,579	875,249	796,248	779,046	48,393,360	**53,595,482**	49,622,116
Total liabilities	500,880,818	450,463,995	26,129,686	11,615,114	48,393,360	**1,037,482,973**	1,010,977,382

*Represents the aggregate of the contractual maturities based on undiscounted cash flows.

Group	Up to 3 months Rs. '000	3-12 months Rs. '000	1-3 years Rs. '000	3-5 years Rs. '000	More than 5 years Rs. '000	**Total as at 31.12.2018 Rs. '000**	Total as at 31.12.2017 Rs. '000
Assets with contractual maturity (interest-bearing assets)							
Cash and cash equivalents	13,528	–	–	–	–	**13,528**	382,763
Placements with banks	8,962,285	8,626,160	–	–	–	**17,588,445**	23,437,274
Financial assets recognised through profit or loss							
– Measured at fair value	1,038,479	637,679	5,879,126	9,246,811	8,186,519	**24,988,614**	7,032,614
Financial assets at amortised cost							
– Loans and advances	24,869,651	76,328,059	116,389,323	75,402,639	130,567,447	**423,557,119**	374,416,626
– Debt and other instruments	36,800,040	60,510,511	102,279,439	126,269,686	197,113,482	**522,973,159**	559,319,752
Financial assets measured at fair value through other comprehensive income	169,290	577,167	574,676	2,566,972	149,939	**4,038,045**	3,072,981
	71,853,273	146,679,576	225,122,564	213,486,108	336,017,387	**993,158,910**	967,662,011

54. Maturity analysis (contd.)

Group	Up to 3 months Rs. '000	3-12 months Rs. '000	1-3 years Rs. '000	3-5 years Rs. '000	More than 5 years Rs. '000	**Total as at 31.12.2018 Rs. '000**	Total as at 31.12.2017 Rs. '000
Other assets (non-interest-bearing assets)							
Cash and cash equivalents	3,423,401	–	–	–	–	**3,423,401**	3,471,226
Balances with central banks	177	–	–	–	–	**177**	94
Derivative financial instruments	4,740,106	–	–	–	–	**4,740,106**	1,360,714
Financial assets recognised through profit or loss							
– Measured at fair value	469,730	1,409,189	–	–	–	**1,878,919**	2,357,336
Financial assets measured at fair value through other comprehensive income	–	–	–	–	3,750,515	**3,750,515**	4,440,951
Investments in subsidiaries	–	–	–	–	–	–	–
Property, plant and equipment	–	–	–	–	13,468,776	**13,468,776**	12,399,334
Deferred tax assets	–	–	–	–	73	**73**	–
Current tax assets	–	–	–	–	–	–	–
Other assets	872,671	9,420,776	8,889,208	6,543,717	5,806,312	**31,532,684**	25,976,944
	9,506,085	10,829,965	8,889,208	6,543,717	23,025,676	**58,794,650**	50,006,600
Total assets	81,359,358	157,509,541	234,011,772	220,029,825	359,043,063	**1,051,953,560**	1,017,668,610
Liabilities with contractual maturity (interest-bearing liabilities)							
Due to banks	63,557,454	8,025,978	12,031,832	–	–	**83,615,264**	49,352,574
Financial liabilities at amortised cost							
– due to depositors	425,141,386	396,295,352	13,301,606	4,836,068	–	**839,574,411**	737,212,640
– due to other borrowers	20,166,606	1,583,572	–	–	–	**21,750,178**	17,545,212
Debt securities issued	–	46,389,133	–	6,000,000	–	**52,389,133**	162,709,027
	508,865,446	452,294,035	25,333,438	10,836,068	–	**997,328,986**	966,819,453
Other liabilities (non-interest-bearing liabilities)							
Derivative financial instruments	–	–	1,533	–	–	**1,533**	956,937
Retirement benefit obligations	–	–	–	–	3,832,777	**3,832,777**	3,712,665
Current tax liabilities	–	–	–	–	–	–	137,344
Deferred tax liabilities	–	–	–	–	582,463	**582,463**	507,138
Other liabilities	2,755,455	875,303	794,859	779,190	247,509	**5,452,317**	5,394,795
Due to subsidiaries	–	–	–	–	–	–	–
Stated capital/Assigned capital	–	–	–	–	9,400,000	**9,400,000**	6,700,000
Statutory reserve fund	–	–	–	–	3,227,960	**3,227,960**	3,002,952
Retained earnings	–	–	–	–	5,198,451	**5,198,451**	1,679,540
Other reserves	–	–	–	–	26,929,073	**26,929,073**	28,757,786
	2,755,455	875,303	796,392	779,190	49,418,233	**54,624,574**	50,849,157
Total liabilities	511,620,901	453,169,338	26,129,830	11,615,258	49,418,233	**1,051,953,560**	1,017,668,610

55 — Fair value of financial instruments

55.1 Financial instruments recorded at fair value

Accounting policy

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

Derivatives

i. Forward exchange purchases

Bank value the forward exchange purchase contracts using the quoted prices available for similar contract for the market.

ii. Foreign currency swaps

Derivative products (Foreign Currency swaps/Cash flow hedges) valued using valuation techniques incorporating various inputs such as foreign exchange spot rates and foreign exchange forward rates.

Financial assets held for trading

i. Government Treasury Bills and Bonds

Financial assets held for trading are valued using a valuation technique consists of Government Treasury Bills and Treasury Bonds. The Bank values the securities using discounted cash flow valuation models which incorporate observable data. Observable inputs include assumptions regarding current rates of interest, broker statements and market data publishing by Central Bank of Sri Lanka.

ii. Equity securities

The Bank values the equity securities using the quoted prices available for the identical securities in active market.

Financial assets available for sales

The Bank values the quoted equity securities using the quoted prices available for the identical securities in active market.

The unquoted equity securities have been fair valued using a valuation model based on observable data.

55.2 Determination of fair value and fair value hierarchy

Level 1 : Quoted (unadjusted) price 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.

55. Fair value of financial instruments (contd.)

55.2 Determination of fair value and fair value hierarchy (contd.)

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

		Bank			
As at 31 December 2018	**Note**	**Level 1 Rs. '000**	**Level 2 Rs. '000**	**Level 3 Rs. '000**	**Total Rs. '000**
Assets					
Derivative financial instruments					
Forward exchange purchases	19	–	–	–	–
Foreign currency swaps	19	–	**4,740,106**	–	**4,740,106**
Financial assets recognised through profit or loss					
Government Treasury Bills and Bonds	20	**14,801,463**	–	–	**14,801,463**
Equity securities	20	**1,878,919**	–	–	**1,878,919**
Financial assets at fair value through other comprehensive income					
Equity securities – quoted	22	**3,447,888**	–	–	**3,447,888**
Other investments – Government securities	22	**2,433,915**	–	–	**2,433,915**
Equity securities – unquoted	22	–	**245,136**	–	**245,136**
Total		**22,562,185**	**4,985,243**	–	**27,547,427**
Liabilities					
Derivative financial instruments	32	–	–	**1,533**	**1,533**

		Bank			
As at 31 December 2017	Note	Level 1 Rs. '000	Level 2 Rs. '000	Level 3 Rs. '000	Total Rs. '000
Assets					
Derivative financial instruments					
Forward exchange purchases	19	650	–	–	650
Foreign currency swaps	19	–	–	1,360,064	1,360,064
Financial assets recognised through profit or loss					
Government Treasury Bills and Bonds	20	4,114,978	–	–	4,114,978
Equity securities	20	2,357,336	–	–	2,357,336
Financial assets at fair value through other comprehensive income					
Equity securities – quoted	22	3,876,570	–	–	3,876,570
Other investments – Government securities	22	1,252,878	–	–	1,252,878
Equity securities – unquoted	22	–	506,890	–	506,890
Total		11,602,413	506,890	1,360,064	13,469,367
Liabilities					
Derivative financial instruments	32	–	956,937	–	956,937

55. Fair value of financial instruments (contd.)

55.2 Determination of fair value and fair value hierarchy (contd.)

		Group			
As at 31 December 2018	Note	**Level 1 Rs. '000**	**Level 2 Rs. '000**	**Level 3 Rs. '000**	**Total Rs. '000**
Assets					
Derivative financial instruments					
Forward exchange purchases	19	–	–	–	–
Foreign currency swaps	19	–	**4,740,106**	–	**4,740,106**
Financial assets recognised through profit or loss					
Government Treasury Bills and Bonds	20	**24,988,614**	–	–	**24,988,614**
Equity securities	20	**1,878,919**	–	–	**1,878,919**
Financial assets at fair value through other comprehensive income					
Equity securities – quoted	22	**3,447,888**	–	–	**3,447,888**
Other investments – Government Securities	22	**4,037,045**	–	–	**4,037,045**
Equity securities – unquoted	22	–	**245,136**	–	**245,136**
Total		**34,352,465**	**4,985,243**	–	**39,337,709**
Liabilities					
Derivative financial instruments	32	–	–	**1,533**	**1,533**

		Group			
As at 31 December 2017	Note	Level 1 Rs. '000	Level 2 Rs. '000	Level 3 Rs. '000	Total Rs. '000
Assets					
Derivative financial instruments					
Forward exchange purchases	19	650	–	–	650
Foreign currency swaps	19	–	–	1,360,064	1,360,064
Financial assets recognised through profit or loss					
Government Treasury Bills and Bonds	20	7,032,614	–	–	7,032,614
Equity securities	20	2,357,336	–	–	2,357,336
Financial assets at fair value through other comprehensive income					
Equity securities – quoted	22	3,876,570	–	–	3,876,570
Other investments – Government Securities	22	3,071,981	–	–	3,071,981
Equity securities – unquoted	22	–	506,890	–	506,890
Total		16,339,150	506,890	1,360,064	18,206,105
Liabilities					
Derivative financial instruments	32	–	956,937	–	956,937

55. Fair value of financial instruments (contd.)

55.3 Reconciliation of movements between levels of fair value measurement hierarchy

Bank and the Group do not have movements between level of hierarchy during the year. Bank and the Group use Level 3 in fair value hierarchy to calculate fair value of derivative instruments and detail of those instruments are given in the Note 19 and 32 on pages 293 and 319.

55.4 Fair value of financial instruments

As at 31 December	Note	Bank 2018 Carrying amount Rs. '000	Bank 2018 Fair value Rs. '000	Bank 2017 Carrying amount Rs. '000	Bank 2017 Fair value Rs. '000
Financial assets					
Cash and cash equivalents	16	**3,434,524**	**3,434,524**	3,849,530	3,849,530
Balances with central banks	17	–	–	–	–
Placement with banks	18	**17,588,445**	**17,588,445**	23,437,274	23,437,274
Derivative financial instruments	19	**4,740,106**	**4,740,106**	1,360,714	1,360,714
Financial assets recognised through profit or loss	20				
– measured at fair value		**16,680,382**	**16,680,382**	6,472,314	6,472,314
– designated at fair value		–	–	–	–
Financial assets at amortised cost					
– loans and advances	21	**423,532,145**	**423,532,145**	375,703,730	375,703,730
– debt and other instruments	22	**518,947,969**	**492,759,226**	555,468,618	554,756,727
Financial assets measured at fair value through other comprehensive income	23	**6,184,430**	**6,184,430**	5,693,829	5,693,829
Total financial assets		**991,108,001**	**964,919,258**	971,986,009	971,274,119
Financial liabilities					
Due to banks	31	**77,119,146**	**77,119,146**	48,596,591	48,596,591
Derivative financial instruments	32	**1,533**	**1,533**	956,937	956,937
Financial liabilities recognised through profit or loss	33	–	–	–	–
Financial liabilities at amortised cost	34				
– due to depositors		**839,574,411**	**838,307,567**	737,212,640	735,574,071
– due to debt securities holders		–	–	–	–
– due to other borrowers		**14,804,802**	**14,804,802**	12,837,008	12,837,008
Debt securities issued	35	**52,389,133**	**52,389,133**	162,709,027	162,709,027
Total financial liabilities		**983,889,024**	**982,622,180**	962,312,204	960,673,635

55. Fair value of financial instruments (contd.)

55.4 Fair value of financial instruments (contd.)

As at 31 December	Note	Group			
		2018		2017	
		Carrying amount Rs. '000	Fair value Rs. '000	Carrying amount Rs. '000	Fair value Rs. '000
Financial assets					
Cash and cash equivalents	16	**3,436,929**	**3,436,929**	3,853,989	3,853,989
Balances with central banks	17	**177**	**177**	94	94
Placement with banks	18	**17,588,445**	**17,588,445**	23,437,274	23,437,274
Derivative financial instruments	19	**4,740,106**	**4,740,106**	1,360,714	1,360,714
Financial assets recognised through profit or loss	20				
– measured at fair value		**26,867,533**	**26,867,533**	9,389,950	9,389,950
– designated at fair value		**–**	**–**	–	–
Financial assets at amortised cost					
– loans and advances	21	**423,557,119**	**423,557,119**	374,416,626	374,416,626
– debt and other instruments	22	**522,973,159**	**496,656,654**	559,319,752	558,686,437
Financial assets measured at fair value through other comprehensive income	23	**7,788,560**	**7,788,560**	7,513,932	7,513,932
Total financial assets		**1,006,952,028**	**980,635,523**	979,292,331	978,659,017
Financial liabilities					
Due to banks	31	**83,615,264**	**83,615,264**	49,352,574	49,352,574
Derivative financial instruments	32	**1,533**	**1,533**	956,937	956,937
Financial liabilities recognised through profit or loss	33	**–**	**–**	–	–
Financial liabilities at amortised cost	34				
– due to depositors		**839,574,411**	**838,307,567**	737,212,640	735,574,071
– due to debt securities holders		**–**	**–**	–	–
– due to other borrowers		**21,750,178**	**21,750,178**	17,545,212	17,545,212
Debt securities issued	35	**52,389,133**	**52,389,133**	162,709,027	162,709,027
Total financial liabilities		**997,330,518**	**996,063,674**	967,776,390	966,137,822

55.5 Determination of fair value

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

The following describes the methodologies and assumptions used to determine the fair values for those financial instruments which are not recorded at faire 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 (original maturities less than a year). It is assumed that the carrying amount approximate their fair values. This assumption is also applied to savings deposits without specific maturity.

Long-term deposits accepted from customers for which periodical interest is paid and loan and receivables granted to customers with a variable rate are also considered to be carried at fair value in the books.

55. Fair value of financial instruments (contd.)

55.5 Determination of fair value (contd.)

Fixed rate financial instruments

Carrying amounts are considered as fair values for short-term credit facilities. In fair valuing held-to maturity securities, rates published by the CBSL for similar trading securities were used. Loans and receivables with fixed interest rates were fair valued using market rates at which fresh loans were granted during the fourth quarter of the reporting year. Conversely, fixed deposits with original tenure above one year and interest paid at maturity were discounted using current market rates offered to customers during the fourth quarter of the reporting year.

Unquoted equities in financial assets

All unquoted equities in financial assets measured at fair value through other comprehensive income (except RDB) are recorded at cost, since its fair value can not be reliably estimated. There is no active market for these investments and Group intends to hold it for the long term. The investment in RDB shares have been fair valued using a valuation model based on observable data. Refer Note 23 (f) on page 309.

56 — Capital management (as per regulatory reporting)

Objective

The Bank is required to manage its capital in order to meet the regulatory requirements and hold sufficient capital buffers to meet the strategic objectives which are aligned with the risk appetite of the Bank.

Regulatory capital

Central Bank of Sri Lanka sets and monitors regulatory capital requirement on both consolidated and solo basis. Basel II guidelines were revoked and with effect from 1 July 2017, the Bank is required to comply with the provisions of the Basel III Direction in respect of regulatory capital and capital to cover any additional risk. The Basel III capital regulations, which are planned to be implemented on a staggered basis by 2019 starting from mid-2017, will continue to be based on the three-mutually reinforcing Pillars introduced under Basel II, i.e., minimum capital requirement, supervisory review process and market discipline.

The Bank currently uses the standardised approach for credit risk, standardised measurement approach for market risk and basic indicator approach for operational risk. Basel III emphasis on increasing the quality and quantity of capital especially the Core Capital, through redefining the common equity capital and introducing new capital buffers such as the Capital Conservation Buffer and a capital surcharge on Domestic Systemically Important Banks (D-SIBs). As per the CBSL Basel III Directive, all D-SIBs are required to maintain a minimum Total Capital Ratio of 14% by year 2019.

Regulatory capital comprises Tier 1 capital and Tier 2 capital. The Bank and the Group have always complied with the minimum capital requirements imposed by the Central Bank of Sri Lanka.

Regulatory capital ratios

	Bank		Group	
As at 31 December	**2018 Basel III**	2017 Basel III	**2018 Basel III**	2017 Basel III
Common equity Tier 1 capital ratio (minimum requirement – 2018 – 7.375%, 2017 – 6.25%)	**13.325**	11.931	**14.140**	12.651
Tier 1 capital ratio (minimum requirement – 2018 – 8.875%, 2017 – 7.75%)	**13.325**	11.931	**14.140**	12.651
Total capital ratio (minimum requirement – 2018 – 12.875%, 2017 – 11.75%)	**16.138**	15.311	**16.882**	15.996

Supplementary Information

Products and Services

GRI 102-2

Savings Products

Ordinary savings account

The Bank offers ordinary savings accounts to anyone aged over seven years, with a minimum deposit of Rs. 100.00. Account holder can make deposits or withdrawals at NSB branch or through SMS/Internet-banking facility.

"Hapan" children's savings account

The *"Hapan"* and *"Punchi Hapan"* are children's savings accounts designed for those between the ages of 8 and 12 and 1 and 7 years, respectively. Deposits in both the said accounts are paid an 1% more interest than what the Bank pays to their other savings accounts.

Neo Savings Account

Neo is a specially designed account for the teens between 13 and 19. Neo offers a 4.5% interest rate for normal Neo accounts and extra 1% will be provided for accounts which are operated only through online. Account holders are entitled to an international debit card which allows a maximum withdrawal limit of Rs. 2,000.00 per day. Also, they enjoy special discounts from selected merchants when purchase goods by using this debit card. Neo account holders will be eligible for scholarship upon selecting for university.

I'M Savings Account

The I'M Savings Account is designed for the purpose of fostering the habit of saving in youth aged between 19 and 30 years, and the Bank offers 0.5% more interest than what it pays for an ordinary savings accounts. I'M account holders enjoy this higher interest rate up until they reach the age of 35. They also enjoy special gifts on the 21st Birthday, Birth of the first child and scholarships upon selecting for University.

"Sthree" Savings Account

The *"Sthree"* Savings Account is designed specifically for women who play different roles in life aged over 16 years with more privileges to celebrate the achievements of life and lend a hand and to shoulder their responsibilities to transform them as heiress to a better tomorrow. *Sthree* account holders entitle to many gifts up to Rs. 50,000.00 upon celebrating special milestones in life such as Graduation, Wedding, Child Birth and 25th Wedding Anniversary. Also, they enjoy a 0.5% interest rate reduction on pawning advances.

NSB Pension+ Account

The "NSB Pension+" is a contributory pension scheme that allows holders to invest any amount into the account over a period of time, or make a lump sum investment. With a minimum balance of Rs. 100,000.00 in the account, account holder will start receiving a pension, upon reaching the age of 55 years.

Happy Savings Account

With a Happy Savings Account, the more you save; the higher the interest you will be paid, up to a maximum of 6.25% interest offers with absolutely no restrictions on withdrawals. This account can be opened by anyone aged over 16 years, with a minimum initial deposit of Rs. 1,000.00.

Smile Savings Account

Any person above the age of 16 years can open and operate a Smile account either individually or jointly. This account can be opened with an initial deposit of Rs. 100.00. Deposits and withdrawals can be made at any NSB branch or Post/Sub-post Office, island-wide.

Pas Avurudu Savings Account

This is a high interest-bearing NSB savings scheme for customers of all ages who prefer long-term saving plans. A customer has to continually make a monthly deposit of Rs. 100.00/200.00/300.00/400.00/500.00 or any multiple of Rs. 1,000.00, over a 60-month period, on any convenient day in a given calendar month.

Reality Savings Plan

This is a specially designed savings plan for the Sri Lankan Migrant Community. Can be opened as an individual, joint or minor savings account and should be maintained only in Sri Lankan Rupees. The maturity period of the plan can be 2,3,4 or 5 years and can have the maturity values as minimum of Rs. 500,000.00 or as multiples of Rs. 500,000.00. Account holders enjoy benefits of insurance cover up to Rs. 1,000,000.00 and personal loans with relaxed terms.

Term deposits

The Bank also accepts tenure-based deposits of fixed amounts for different maturity periods. A term deposit customer may withdraw his/her money before the expiry of the relevant maturity period in accordance with the applicable premature rates. Tenures range from three months to five years, and they indeed are targeted at children, senior citizens, societies and corporates.

Fixed Deposits (FDs)

Any person of over 16 years of age can open a NSB Fixed Deposit Account, either individually or jointly with someone, while parents/guardians can open and operate an account, on behalf of a child, provided the child concerned is below 16 years of age. The minimum amount required to open a 12-month FD is Rs. 1,000.00, and if one wants to open a monthly interest earning 12-month FD, then, the minimum amount is Rs. 25,000.00. Fixed deposit accounts can be opened for 3/6/12/24/36/60 months maturity periods. FD customer can raise a loan against the deposit.

Prarthana Children's Savings Certificate

A long-term deposit scheme for kids with attractive interest rates paid in upfront. The *"Prarthana"* Savings Certificate matures when the account holder reaches 16 years of age.

Gaurawa FD Account

Any senior citizen aged over 55 years can open a Gaurawa Fixed Deposit Account, which will earn for the customer a monthly interest, which will always be 0.5% above the rate paid to the Bank's normal FD customer. The minimum deposit, a senior citizen can deposit in a Gaurawa FD a/c is Rs. 25,000.00, while the maximum is Rs. 20 Mn.

Senior Citizens' Special Fixed Deposit

It is a fixed deposit for senior citizens aged over 60 years. The Maximum amount that can be deposited in a Senior Citizen's Special Fixed Deposit is Rs. 1.5 Mn., while a holder of this deposit will earn 15% as interest, upon maturity.

Foreign Currency Products

Foreign Currency Savings Accounts/ Term deposits

The Bank also offers foreign currency savings deposits or term deposits to both resident and non-resident Sri Lankans. A Personal Foreign Currency Accounts (NR) can be opened by any Sri Lankan national employed abroad, while a Personal Foreign Currency Accounts (R) can be opened by any resident citizen who is either in possession of foreign currency or is receiving foreign currency remittances. Then, Special Inward Investment Accounts (IIA) are on offer for foreign nationals, Sri Lankan citizens resident abroad, Non-nationals of Sri Lankan origin resident abroad, corporate entities incorporated outside Sri Lanka and foreign institutional investors.

Retail Lending Products

Home/Property Loans

The Bank offers home loans to people who intent to construct, renovate, purchase, or repair a home, to purchase a land to build a house on as well as to pay off a home loan obtained from another financial institution. The following are the home loan products which are available for different customer segments.

- *Ge Dora*
- *Alankara*
- *Vikasitha*
- *Home loans for government employees*

Personal loans

The Bank offers personal loans to its customers for meeting the costs; associated with the purchase of consumer goods, healthcare, travel abroad, solar panels and education. The Bank obtains the security interest over properties such as primary mortgage of the borrower's property, item purchased, surrender value of the borrowers' life insurance policy or Government Securities they own. This loan is also available with personal guarantors. The repayment period and the amount of a loan are dependent on the nature of the collateral provided and the prospective borrower's circumstances.
The following personal loans are available:

- Normal personal loan;
- *Buddhi* loan;
- Special pension loan;
- *Charika* loan;
- Eco loan.
- *Sonduru Piyasa* loan

Auto Loan

Auto loans are granted to cover up to 75% of the purchase price of an unregistered vehicle, and up to 60% of the price of a registered vehicle. This loan can also be raised to pay off an auto loan obtained from another legitimate source. An auto loan will be released within two or three days of making an application.

Loans against deposits – Speed loans

Speed loans are loans granted against the deposits of an account holder. The Bank offers speed loans of up to 90% of a customer's deposits with the Bank, while the deposits will serve as security.

Products and Services

ECO loan →

NSB Eco loan is designed to provide financial assistance to those who are interested having a solar power generation system installed in their homes, enabling them to go green and save on their electricity bills, at the same time.

Enterprise Sri Lanka loan scheme →

Bank grant below loan schemes under the Enterprise Sri Lanka programme introduced by the Government.

- *Ran Aswenna* – Granted for small scale farmers and farming societies, flower gardeners and fisheries. Can obtain credit facility up to Rs. 5,000,000.00
- *Govi Navoda* – The facility is granted to small scale farmers and farming societies to purchase agricultural equipment. Can obtain up to Rs. 500,000.00
- *Haritha Naya* – The maximum amount can be granted is Rs. 5,000,000.00 and this is offered to small scale hotel owners providing tourism services who have registered under Sri Lanka Tourist Development Authority (SLTDA)
- *Jaya Isura* – This credit facility is granted for medium scale entrepreneurs in the field of agriculture, fishery, gardening, printing, tourism, hand craft and information technology. Maximum loan amount can be granted will differ according to the size of the company and the annual turnover.

Corporate Lending

The Bank is also engaged in corporate lending for long-term infrastructure or other development projects, in the areas of power generation, telecommunication, healthcare, highway and irrigation etc. Such loans will be granted in the form of direct loans to a bank/ financial institution, either as part of a syndicated loan or to private corporate entities/State Owned Enterprises (SOE), as a direct loan.

Card Services

Shopping + ATM Card →

The Bank issues "Shopping + ATM Cards'' connected to customers' savings accounts which provides easy access to cash by enabling the customers to make ATMs withdrawals and pay for their purchases.

NSB Easy Card →

The "NSB Easy Card" is a mastercard that is issued against the balance in customer's fixed deposit account, with credit limit of up to 80% of the deposit balance. Additionally cardholders can also withdraw cash with their NSB Easy card from any ATM with Mastercard logo, including all NSB ATMs.

Other Services

Trade Finance Services →

The Bank facilitates import trade transactions targeting the retail sector; especially importation of motor vehicles. Issuance of Letters of Credit (LC), handling import bills under LC, issuance of shipping and air freight guarantees, collection of bills and forward exchange bookings are the services offered at all the branches under trade financing.

Treasury Services →

This services include money market activities, trading in Government Securities and derivative transactions.

NSB U-Trust →

"NSB U-Trust" is the Bank's foreign currency remittance service. Through this service, Sri Lankans working abroad can remit their earnings to their families back home. In fact, money can be sent either to a NSB account or to an account elsewhere. A beneficiary can also collect his/her remittance, over the counter, at any NSB branch or main Post Office.

Money Changing Business →

With the approval of Central Bank of Sri Lanka to engage in Money Changing Business, NSB offers the service to the customers who possess foreign currency notes to convert them and also customers who travel abroad could purchase foreign currency notes at the selected branches at competitive exchange rates.

NSB Reach →

"NSB Reach" is the Bank's POS device-based savings mobilisation programme, which has enabled mostly underbanked people to save from where they are, without going through the hassle of visiting a branch, as its tagline "Your Address is Our Address" says.

NSB iSaver

NSB iSaver is a digital innovation which is expected to provide customer convenience through Mobitel standalone and all franchisee outlets at any time during the day. This innovative service is expected to further inculcate the habit of savings amongst Sri Lanka's populace, thus resulting in wealth creation and mobility of funds for investment.

Now from anywhere and at anytime you can deposit to your NSB savings account through your nearest mCash retailers island-wide from the NSB iSaver Service.

Advantages of NSB iSaver

- Extended operational hours
- Weekend and holiday banking.
- Real-time transaction process.
- Hassle-free customer convenience
- Low cost on deposits mobilisation

No fee will be charged from the savings account holders or third party depositor.

Guarantees

This is an instrument, which amounts to an unconditional undertaking by the Bank, to discharge the liability of a depositor; in the event of his/her failing to discharge the obligation. The following types of guarantees can be issued against deposits on the request of the customer: Performance Bonds, Bid Bonds, Retention Bonds, Retention Guarantees, Tender Bonds, Advance Payment Guarantees.

Standing Order

A standing order will enable you to authorise the Bank to make a series of payments on your behalf to a names payee or beneficiary by debiting your savings account with a fixed payment amount. Standing order within the NSB accounts are free of charge.

Safety Deposit Locker

NSB provides you with a safe and trusted place for safekeeping of your valued belongings. You will receive the facility to store your valuable belongings and documents under safe custody at a nominal annual rental at selected branches. Safety Lockers are available in three sizes as Small, Medium and Large.

Nomination

An account holder can nominate a person who shall be entitled to the money of the stated account in the event of the nominator's demise. You, as the account holder, have the authority to change the nominee/nominees at your discretion.

Utility Bill Payments

Utility Bill Payment Services are available at NSB and you can pay utility bills at any of our branches island-wide. Bills will be updated online as soon as you pay your bill.

SMS Banking

SMS Banking service is available to any NSB savings account holder. With SMS Banking, customers can pay their utility bills and transfers funds between NSB accounts.

Internet Banking

The Bank also provides the Internet banking facility to its customers. Indeed, Internet banking allows NSB customers to check their account balances, transfer funds from their accounts to any account, no matter which bank the transferee's account is, on top of reloading facility and paying utility bills, online.

Collection centers of schools

NSB was involved in establishing School Banks, where school children learn the habit of savings and get used to leadership role within the school.

NSB Call Centre

The NSB Call Centre provides assistance to customers to contact the Bank and Inquire about the Bank's activities. Indeed, any person can come to the Call Centre on +94 11 237 9379 and get information related to any NSB product or service. As well, they can reach it via email, Skype too. What's more, web-chatting too is possible, if they so wish to.

Income Statement in US Dollars

For the year ended 31 December	Bank			Group		
	2018 USD '000	2017 USD '000	Change %	**2018 USD '000**	2017 USD '000	Change %
Gross income	**612,463**	704,795	(13)	**617,161**	706,354	(13)
Interest income	**604,827**	675,970	(11)	**611,460**	681,488	(10)
Less: Interest expenses	**468,628**	511,942	(8)	**473,215**	515,484	(8)
Net interest income	**136,199**	164,028	(17)	**138,246**	166,004	(17)
Fee and commission income	**5,502**	5,109	8	**5,520**	5,124	8
Less: Fee and commission expenses	**773**	712	9	**792**	738	7
Net fee and commission income	**4,729**	4,397	8	**4,728**	4,386	8
Net gain/(loss) from trading	**(3,872)**	7,873	(149)	**(5,815)**	9,925	(159)
Net fair value gains/(losses) from financial instruments at fair value through profit or loss	**–**	–	–	**–**	–	–
Net gains/(losses) from derecognition of financial assets	**38**	4,617	(99)	**38**	4,617	(99)
Net other operating income	**5,968**	11,227	(47)	**5,958**	5,201	15
Total operating income	**143,062**	192,142	(26)	**143,154**	190,132	(25)
Less: Impairment charges	**4,767**	4,998	(5)	**4,767**	4,998	(5)
Net operating income	**138,295**	**187,144**	**(26)**	**138,387**	**185,134**	**(25)**
Less: Expenses						
Personnel expenses	**50,697**	44,942	13	**50,915**	45,153	13
Depreciation and amortisation expenses	**3,496**	2,764	26	**3,502**	2,769	26
Other expenses	**22,960**	24,391	(6)	**22,773**	24,034	(5)
Operating profit before VAT, NBT and DRL on financial services	**61,142**	115,047	(47)	**61,198**	113,178	(46)
Less: Value added tax (VAT) on financial services	**14,108**	20,118	(30)	**14,144**	20,677	(32)
Nation Building Tax (NBT) on financial services	**1,881**	2,682	(30)	**1,886**	2,757	(32)
Debt Repayment Levy (DRL) on financial services	**1,688**	–	100	**1,688**	–	100
Operating profit after VAT, NBT and DRL on financial services	**43,465**	92,247	(53)	**43,480**	89,744	(52)
Share of profits of associates and joint ventures	**–**	–	–	**–**	–	–
Profit before income tax	**43,465**	92,247	(53)	**43,480**	89,744	(52)
Less: Income tax expenses	**18,835**	28,839	(35)	**18,850**	29,988	(37)
Profit for the year	**24,630**	63,408	(61)	**24,630**	59,756	(59)
Profit attributable to:						
Equity holders of the Bank	**24,630**	63,408	(61)	**24,630**	59,756	(59)
Non-controlling interests	**–**	–	–	**–**	–	–
Profit for the year	**24,630**	63,408	(61)	**24,630**	59,756	(59)
Earnings per share on profit						
Basic earnings per ordinary share (USD)	**0.04**	0.10	(60)	**0.04**	0.10	(60)
Diluted earnings per ordinary share (USD)	**0.04**	0.10	(60)	**0.04**	0.10	(60)
Profit for the year	**24,630**	63,408	(61)	**24,630**	59,756	(59)

Statement of Comprehensive Income in US Dollars

	Bank			Group		
For the year ended 31 December	**2018 USD '000**	2017 USD '000	Change %	**2018 USD '000**	2017 USD '000	Change %
Profit for the year	**24,630**	63,408	(61)	**24,630**	59,756	(59)
Items that will be reclassified to income statement						
Exchange differences on translation of foreign operations	–	–	–	–	–	–
Net gains/(losses) on cash flow hedges	**(1,598)**	1,893	(184)	**(1,598)**	1,893	(184)
Net gains/(losses) on investments in debt instruments measured at fair value through other comprehensive income	–	–	–	–	–	–
Share of profits of associates and joint ventures	–	–	–	–	–	–
Debt instruments at fair value through other comprehensive income	**(699)**	4,526	(115)	**(816)**	5,605	(115)
Less: Fair value gains/(losses) transferred to income statement on disposal of debt instrument at fair value through other comprehensive income	**7**	(4,506)	(100)	**7**	(4,506)	(100)
Less: Tax expense relating to items that will be reclassified to income statement	–	–	–	–	–	–
Total items that will be reclassified to income statement	**(2,289)**	1,914	(220)	**(2,407)**	2,992	(180)
Items that will not be reclassified to income statement						
Change in fair value on investments in equity instruments designated at fair value through other comprehensive income	**(3,779)**	(240)	1,475	**(3,779)**	(240)	1,475
Change in fair value attributable to change in the Bank's own credit risk on financial liabilities designated at fair value through profit or loss	–	–	–	–	–	–
Remeasurement of post-employment benefit obligations	**(1,154)**	(13,525)	(91)	**(1,156)**	(13,523)	(91)
Changes in revaluation surplus	–	29,423	(100)	–	29,423	(100)
Share of profits of associates and joint ventures	–	–	–	–	–	–
Less: Tax expense relating to items that will not be reclassified to income statement	–	–	–	–	–	–
Total items that will not be reclassified to income statement	**(4,933)**	15,658	(132)	**(4,935)**	15,660	(132)
Other comprehensive income for the year, net of taxes	**(7,222)**	17,572	(141)	**(7,342)**	18,652	(139)
Total comprehensive income for the year	**17,408**	80,980	(79)	**17,289**	78,408	(78)
Attributable to:						
Equity holders of the Bank	**17,408**	80,980	(79)	**17,289**	78,408	(78)
Non-controlling interests	–	–	–	–	–	–
Total comprehensive income for the year	**17,408**	80,980	(79)	**17,289**	78,408	(78)
US Dollars conversion rate (Rs.)	**182.7084**	153.2300		**182.7084**	153.2300	

Statement of Financial Position in US Dollars

As at 31 December	Bank 2018 USD '000	Bank 2017 USD '000	Bank Change %	Group 2018 USD '000	Group 2017 USD '000	Group Change %
Assets						
Cash and cash equivalents	**18,798**	25,123	(25)	**18,811**	25,152	(25)
Balances with central banks	–	–	–	**1**	1	–
Placements with banks	**96,265**	152,955	(37)	**96,265**	152,955	(37)
Derivative financial instruments	**25,944**	8,880	192	**25,944**	8,880	192
Financial assets recognised through profit or loss						
– measured at fair value	**91,295**	42,239	116	**147,051**	61,280	140
– designated at fair value	–	–	–	–	–	–
Financial assets at amortised cost						
– loans and advances	**2,318,077**	2,451,894	(5)	**2,318,214**	2,443,494	(5)
– debt and other instruments	**2,840,307**	3,625,064	(22)	**2,862,338**	3,650,197	(22)
Financial assets measured at fair value through other comprehensive income	**33,849**	37,159	(9)	**42,628**	49,037	(13)
Investments in subsidiaries	**9,304**	5,874	58	–	–	–
Investments in associates and joint ventures	–	–	–	–	–	–
Property, plant and equipment	**73,701**	80,896	(9)	**73,717**	80,920	(9)
Investment properties	–	–	–	–	–	–
Goodwill and intangible assets	–	–	–	–	–	–
Deferred tax assets	–	–	–	–	–	–
Other assets	**170,814**	167,694	2	**172,585**	169,529	2
Total assets	**5,678,354**	6,597,777	(14)	**5,757,554**	6,641,445	(13)
Liabilities						
Due to banks	**422,089**	317,148	33	**457,643**	322,082	42
Derivative financial instruments	**8**	6,245	(100)	**8**	6,245	(100)
Financial liabilities recognised through profit or loss	–	–	–	–	–	–
Financial liabilities at amortised cost						
– due to depositors	**4,595,160**	4,811,151	(4)	**4,595,160**	4,811,151	(4)
– due to debt securities holders	–	–	–	–	–	–
– due to other borrowers	**81,030**	83,776	(3)	**119,043**	114,502	4
Debt securities issued	**286,736**	1,061,861	(73)	**286,736**	1,061,861	(73)
Retirement benefit obligations	**20,967**	24,221	(13)	**20,978**	24,229	(13)
Current tax liabilities	–	–	–	–	896	(100)
Deferred tax liabilities	**3,188**	3,309	(4)	**3,188**	3,310	(4)
Other provisions	–	–	–	–	–	–
Other liabilities	**29,814**	34,916	(15)	**29,842**	35,207	(15)
Due to subsidiaries	**4**	5	(20)	–	–	–
Total liabilities	**5,438,996**	6,342,633	(14)	**5,512,599**	6,379,484	(14)
Equity						
Stated capital/assigned capital	**51,448**	43,725	18	**51,448**	43,725	18
Statutory reserve fund	**17,667**	19,598	(10)	**17,667**	19,598	(10)
Retained earnings	**25,298**	7,197	252	**28,452**	10,961	160
Other reserves	**144,945**	184,624	(21)	**147,388**	187,677	(21)
Total shareholders' equity	**239,358**	255,144	(6)	**244,955**	261,961	(6)
Non-controlling interests	–	–	–	–	–	–
Total equity	**239,358**	255,144	(6)	**244,955**	261,961	(6)
Total equity and liabilities	**5,678,354**	6,597,777	(14)	**5,757,554**	6,641,445	(13)
Contingent liabilities and commitments	**24,528**	119,561	(79)	**24,528**	119,561	(79)
US Dollars conversion rate (Rs.)	**182.7084**	153.2300		**182.7084**	153.2300	

Basel III Disclosures as per Schedule III of Banking Act Direction No. 1 of 2016

Basel III – Minimum Disclosure Requirements under Pillar III

Key Regulatory Ratios – Capital and Liquidity

Item	Bank		Group	
	31.12.2018	31.12.2017	**31.12.2018**	31.12.2017
Regulatory capital (Rs. '000)				
Common equity Tier 1	**30,434,481**	25,564,909	**32,750,842**	27,370,741
Tier 1 capital	**30,434,481**	25,564,909	**32,750,842**	27,370,741
Total capital	**36,859,411**	32,808,403	**39,102,064**	34,605,855
Regulatory capital ratios (%)				
Common Equity Tier 1 capital ratio (minimum requirement: 2018 – 7.375% , 2017 – 6.25%)	**13.325**	11.931	**14.140**	12.651
Tier 1 Capital Ratio (minimum requirement: 2018 – 8.875%, 2017 – 7.75%)	**13.325**	11.931	**14.140**	12.651
Total Capital Ratio (minimum requirement: 2018 – 12.875%, 2017 – 11.75%)	**16.138**	15.311	**16.882**	15.996
Leverage ratio (minimum requirement: 3%)*	**4.86**	–	**5.00**	–
Regulatory liquidity				
Statutory liquid assets (Rs. '000)	**424,490,106**	509,079,407	**N/A**	N/A
Statutory liquid assets ratio (minimum requirement – 20%)			**N/A**	N/A
Domestic banking unit (%)	**54.88**	73.44	**N/A**	N/A
Off-shore banking unit (%)	**–**	–	**N/A**	N/A
Liquidity coverage ratio (%) – rupee (minimum requirement – 2018 – 90%, 2017 – 80%)	**245.06**	377.57	**N/A**	N/A
Liquidity coverage ratio (%) – all currency (minimum requirement – 2018 – 90%, 2017 – 80%)	**321.29**	376.18	**N/A**	N/A

* Implementation date for regulatory reporting will be with effect from 1 January 2019.

Basel III Disclosures as per Schedule III of Banking Act Direction No. 1 of 2016

Basel III – Computation of Capital Ratios

Item	Bank		Group	
	31.12.2018 Rs. '000	31.12.2017 Rs. '000	**31.12.2018 Rs. '000**	31.12.2017 Rs. '000
Common Equity Tier 1 (CET1) Capital after adjustments	**30,434,481**	25,564,909	**32,750,842**	27,370,741
Total Common Equity Tier 1 (CET1) Capital	**35,721,269**	30,655,010	**36,653,467**	31,654,889
Equity capital (stated capital)/Assigned capital	**9,400,000**	6,700,000	**9,400,000**	6,700,000
Reserve fund	**3,227,960**	3,002,952	**3,227,960**	3,002,952
Published retained earnings/(Accumulated retained losses)	**115,634**	(3,122,124)	**692,093**	(2,545,305)
Published accumulated other comprehensive income (OCI)	**(114,210)**	982,297	**(252,431)**	912,206
General and other disclosed reserves	**23,091,885**	23,091,885	**23,585,844**	23,585,036
Unpublished current year's profit/(losses) and gains reflected in OCI	–	–	–	–
Ordinary shares issued by consolidated banking and financial subsidiaries of the Bank and held by third parties	–	–	–	–
Total adjustments to CET1 Capital	**5,286,788**	5,090,100	**3,902,624**	4,284,148
Goodwill (net)	–	–	–	–
Intangible assets (net)	**576,075**	380,308	**576,341**	380,655
Revaluation losses of property, plant and equipment	**19,183**	19,183	**19,183**	19,183
Deferred tax assets (net)	–	–	**73**	–
Cash flow hedge reserve	–	291,924	–	291,924
Investments in the capital of banking and financial institutions where the Bank does not own more than 10% of the issued ordinary share capital of the entity	**3,309,693**	3,597,821	**3,307,027**	3,592,386
Significant investments in the capital of financial institutions where the Bank owns more than 10% of the issued ordinary share capital of the entity	**1,381,837**	800,864	–	–
Additional Tier 1 (AT1) Capital after adjustments	–	–	–	–
Total Additional Tier 1 (AT1) Capital	–	–	–	–
Qualifying Additional Tier 1 capital instruments	–	–	–	–
Instruments issued by consolidated banking and financial subsidiaries of the Bank and held by third parties	–	–	–	–
Total adjustments to AT1 Capital	–	–	–	–
Investment in own shares	–	–	–	–
Tier 2 Capital after adjustments	**6,424,930**	7,243,494	**6,351,222**	7,235,114
Total Tier 2 Capital	**8,846,497**	9,855,227	**8,846,497**	9,855,227
Qualifying Tier 2 Capital instruments	**3,600,000**	4,800,000	**3,600,000**	4,800,000
Revaluation gains	**3,565,866**	3,565,866	**3,565,866**	3,565,866
Loan loss provisions	**1,680,631**	1,489,362	**1,680,631**	1,489,362
Instruments issued by consolidated banking and financial subsidiaries of the Bank and held by third parties	–	–	–	–

Basel III Disclosures as per Schedule III of Banking Act Direction No. 1 of 2016

Item	Bank		Group	
	31.12.2018 Rs. '000	31.12.2017 Rs. '000	**31.12.2018 Rs. '000**	31.12.2017 Rs. '000
Total adjustments to Tier 2 Capital	**2,421,567**	2,611,733	**2,495,275**	2,620,113
Investment in own shares	–	–	–	–
Investments in the capital of financial institutions and where the Bank does not own more than 10% of the issued capital carrying voting rights of the issuing entity	**2,421,567**	2,611,733	**2,495,275**	2,620,113
CET 1 Capital	**30,434,481**	25,564,909	**32,750,842**	27,370,741
Total Tier 1 Capital	**30,434,481**	25,564,909	**32,750,842**	27,370,741
Total Capital	**36,859,411**	32,808,403	**39,102,064**	34,605,855
Total Risk Weighted Assets (RWA)	**228,405,468**	214,281,753	**231,620,561**	216,344,080
RWAs for Credit Risk	**185,794,966**	157,267,128	**185,358,837**	157,555,103
RWAs for Market Risk	**11,400,132**	22,109,583	**14,831,899**	23,537,259
RWAs for Operational Risk	**31,210,369**	34,905,043	**31,429,825**	35,251,718
CET 1 Capital Ratio (including Capital Conservation Buffer, Countercyclical Capital Buffer and Surcharge on D-SIBs (%)	**13.325**	11.931	**14.140**	12.651
of which: Capital Conservation Buffer (%)	**1.875**	1.250	**1.875**	1.250
of which: Countercyclical Buffer (%)	**0.000**	0.000	**0.000**	0.000
of which: Capital Surcharge on D-SIBs (%)	**1.000**	0.500	**1.000**	0.500
Total Tier 1 Capital Ratio (%)	**13.325**	11.931	**14.140**	12.651
Total Capital Ratio (including Capital Conservation Buffer, Countercyclical Capital Buffer and Surcharge on D-SIBs) (%)	**16.138**	15.311	**16.882**	15.996
of which: Capital Conservation Buffer (%)	**1.875**	1.250	**1.875**	1.250
of which: Countercyclical Buffer (%)	**0.000**	0.000	**0.000**	0.000
of which: Capital Surcharge on D-SIBs (%)	**1.000**	0.500	**1.000**	0.500

The difference arises between the retained earnings balance in Basel III capital adequacy computation and the financial reporting are due to the following:

(1) The Bank's practice was to transfer the current year retained earnings to the general reserve until end of 2015 and it was changed to maintain part of the current year retained earnings to a separately maintained Retained Earnings Reserve with effect from 31 December 2016. Therefore one of the differences between the retained earnings balance in the financial reporting and the Basel III capital adequacy computation is the accumulated actuarial loss of Rs. 5.351 Bn. on retirement benefit plan which has been adjusted to the general reserve prior to 2016.

(2) Further, with the adoption of the SLFRS 9, only 25% of the first day impact of Rs. 1.126 Bn. considered in Basel III capital adequacy computation as the Bank is allowed to stagger the first day impact throughout a transitional period of four years by CBSL, whereas first day impact in full is considered in the financial reporting.

Basel III Disclosures as per Schedule III of Banking Act Direction No. 1 of 2016

Computation of Leverage Ratio

Item	Bank	Group
	Rs. '000	Rs. '000
Tier 1 Capital	30,434,481	32,750,842
Total Exposures	625,952,845	655,042,559
On-Balance Sheet Items (excluding derivatives, and securities financing transactions, but including collateral)	543,269,728	559,100,363
Derivative Exposures	454,442	454,442
Securities Financing Transaction Exposures	79,981,972	93,241,051
Other Off-Balance Sheet Exposures	2,246,703	2,246,703
Basel III Leverage Ratio (%) (Tier 1/Total Exposure)	4.86%	5.00%

* Implementation date for regulatory reporting will be with effect from 1 January 2019.

Basel III – Computation of Liquidity Coverage Ratio (Bank) – All Currency

Item	2018		2017	
	Total unweighted value Rs. '000	**Total weighted value Rs. '000**	Total unweighted value Rs. '000	Total weighted value Rs. '000
Total Stock of high-quality liquid assets (HQLA)	**422,527,455**	**419,793,574**	430,221,226	426,508,743
Total adjusted Level 1A assets	**423,926,486**	**423,926,486**	431,889,252	431,889,252
Level 1 assets	**416,569,693**	**416,569,693**	422,446,260	422,446,260
Total adjusted Level 2A assets	**700,000**	**595,000**	500,000	425,000
Level 2A assets	**700,000**	**595,000**	500,000	425,000
Total adjusted Level 2B assets	**5,257,763**	**2,628,881**	7,274,966	3,637,483
Level 2B assets	**5,257,763**	**2,628,881**	7,274,966	3,637,483
Total cash outflows	**942,681,904**	**185,180,897**	812,037,851	126,236,382
Deposits	**686,030,059**	**68,603,006**	611,264,221	61,126,422
Unsecured wholesale funding	**140,398,948**	**72,159,192**	114,458,122	58,912,164
Secured funding transactions	**66,860,079**	–	57,193,088	–
Undrawn portion of committed (irrevocable) facilities and other contingent funding obligations	**5,198,560**	**238,338**	24,722,883	1,812,059
Additional requirements	**44,194,258**	**44,194,258**	4,399,536	4,399,536
Total cash inflows	**23,871,472**	**54,523,804**	25,850,376	12,858,107
Maturing secured lending transactions backed by collateral	**4,801,432**	**2,450,006**	7,704,695	2,115,566
Committed facilities	–	–	–	–
Other inflows by counterparty which are maturing within 30 days	**16,118,248**	**11,262,873**	15,514,164	10,742,542
Operational deposits	**2,951,791**	–	2,631,518	–
Other cash inflows	**40,810,925**	**40,810,925**	–	–
Liquidity Coverage Ratio (%) (stock of high quality liquid assets/total net cash outflow over the next 30 calendar days)*100	–	**321.29**	–	376.18

Main Features of Regulatory Capital Instruments

Description of the capital instrument	
Issuer	National Savings Bank
Unique identifier	
Governing law(s) of the instrument	Sri Lanka
Original date of issuance	29 December 2016
Par value of instrument	100
Perpetual or dated	Dated
Original maturity date	29 December 2021
Amount recognised in regulatory capital (Rs. '000)	3,600,000
Accounting classification (equity/liability)	Liability
Issuer call subject to prior supervisory approval	
Optional call date, contingent call dates and redemption amount (Rs. '000)	N/A
Subsequent call dates	N/A
Coupons/dividends	
Fixed or floating dividend/coupon	Fixed
Coupon rate and any related index	13%
Non-cumulative or cumulative	Non-cumulative
Convertible or non-convertible	
If convertible, conversion trigger(s)	N/A
If convertible, fully or partially	N/A
If convertible, mandatory or optional	N/A
If convertible, conversion rate	N/A

Summary discussion on adequacy/meeting current and future capital requirements

For summary discussion on adequacy/meeting current and future capital requirements, refer risk management report on pages 223 to 226.

Basel III Disclosures as per Schedule III of Banking Act Direction No. 1 of 2016

Credit Risk under Standardised Approach (Bank)

Credit Risk Exposures and Credit Risk Mitigation (CRM) Effects

As at 31 December 2018	Exposures before Credit conversion factor (CCF) and CRM		Exposures post CCF and CRM		RWA and RWA density	
Asset class	On-balance sheet amount Rs. '000	Off-balance sheet amount Rs. '000	On-balance sheet amount Rs. '000	Off-balance sheet amount Rs. '000	RWA Rs. '000	RWA density [ii] (%)
Claims on Central Government and CBSL	541,037,145	40,809,393	538,679,906	816,188	35,712	0.0
Claims on foreign sovereigns and their central banks	–	–	–	–	–	–
Claims on public sector entities	130,743,609	460,596	57,491	–	57,491	100.0
Claims on official entities and multilateral development banks	–	–	–	–	–	–
Claims on banks exposures	44,965,188	–	44,965,188	–	21,067,423	46.9
Claims on financial institutions	12,758,192	186,386	12,758,192	93,193	6,442,190	50.1
Claims on corporates	12,249,702	131,550	12,249,702	65,775	4,253,912	34.5
Retail claims	182,085,576	2,165,701	154,935,080	134,890	94,043,642	60.6
Claims secured by residential property	65,899,139	801,015	65,899,139	400,508	33,387,867	50.4
Claims secured by commercial real estate	–	–	–	–	–	–
Non-performing assets (NPAs)[i]	5,203,492	–	5,203,492	–	6,391,586	122.8
Higher risk categories	318,163	–	318,163	–	795,408	250.0
Cash items and other assets	19,417,844	736,149	19,417,844	736,149	19,319,736	95.9
Total	**1,014,678,049**	**45,290,790**	**854,484,197**	**2,246,703**	**185,794,966**	**21.7**

Note:
(i) NPAs – As per Banking Act Directions on classification of loans and advances, income recognition and provisioning.
(ii) RWA Density – Total RWA/exposures post CCF and CRM.

Basel III Disclosures as per Schedule III of Banking Act Direction No. 1 of 2016

Credit Risk under Standardised Approach (Group)

Credit Risk Exposures and Credit Risk Mitigation (CRM) Effects

As at 31 December 2018	Exposures before Credit conversion factor (CCF) and CRM		Exposures post CCF and CRM		RWA and RWA density	
Asset class	On-balance sheet amount Rs. '000	Off-balance sheet amount Rs. '000	On-balance sheet amount Rs. '000	Off-balance sheet amount Rs. '000	RWA Rs. '000	RWA density (ii) (%)
Claims on Central Government and CBSL	545,158,807	40,809,393	542,776,595	816,188	35,712	0.0
Claims on foreign sovereigns and their central banks	–	–	–	–	–	–
Claims on public sector entities	130,743,609	460,596	57,491	–	57,491	100.0
Claims on official entities and multilateral development banks	–	–	–	–	–	–
Claims on banks exposures	45,017,575	–	45,017,575	–	21,090,299	46.8
Claims on financial institutions	12,854,155	186,386	12,854,155	93,193	6,461,440	49.9
Claims on corporates	12,382,231	131,550	12,382,231	65,775	4,281,218	34.4
Retail claims	182,085,576	2,165,701	154,935,080	134,890	94,043,642	60.6
Claims secured by residential property	65,899,139	801,015	65,899,139	400,508	33,387,867	50.4
Claims secured by commercial real estate	–	–	–	–	–	–
Non-performing assets (NPAs)(i)	5,203,492	–	5,203,492	–	6,391,586	122.8
Higher risk categories	–	–	–	–	–	–
Cash items and other assets	19,707,702	736,149	19,707,702	736,149	19,609,584	95.9
Total	**1,019,052,285**	**45,290,790**	**858,833,459**	**2,246,703**	**185,358,837**	**21.5**

Note:
(i) NPAs – As per Banking Act Directions on classification of loans and advances, income recognition and provisioning.
(ii) RWA Density – Total RWA/Exposures post CCF and CRM.

Basel III Disclosures as per Schedule III of Banking Act Direction No. 1 of 2016

Credit Risk under Standardised Approach: Exposures by Asset Classes and Risk Weights (Bank)

As at 31 December 2018 Description	(Post CCF and CRM)							
Risk weight / Asset classes	0% Rs. '000	20% Rs. '000	50% Rs. '000	75% Rs. '000	100% Rs. '000	150% Rs. '000	>150% Rs. '000	Total credit exposures amount Rs. '000
Claims on Central Government and CBSL	539,317,534	178,560	–	–	–	–	–	539,496,093
Claims on foreign sovereigns and their central banks	–	–	–	–	–	–	–	–
Claims on public sector entities	–	–	–	–	57,491	–	–	57,491
Claims on official entities and multilateral development banks	–	–	–	–	–	–	–	–
Claims on banks exposures	–	15,222,979	23,438,768	–	6,303,442	–	–	44,965,189
Claims on financial institutions	–	1,923,086	9,741,454	–	1,186,845	–	–	12,851,385
Claims on corporates	–	9,465,626	978,128	–	1,871,723	–	–	12,315,477
Retail claims	29,675,178	4,457	–	125,390,334	–	–	–	155,069,970
Claims secured by residential property	–	–	65,823,559	–	476,088	–	–	66,299,647
Claims secured by commercial real estate	–	–	–	–	–	–	–	–
Non-performing assets (NPAS)	–	–	34,575	–	2,758,149	2,410,766	–	5,203,491
Higher risk categories	–	–	–	–	–	–	318,163	318,163
Cash items and other assets	687,687	183,213	–	–	19,283,093	–	–	20,153,992
Total	569,680,399	26,977,920	100,016,484	125,390,334	31,936,831	2,410,766	318,163	856,730,900

Credit Risk under Standardised Approach: Exposures by Asset Classes and Risk Weights (Group)

As at 31 December 2018 Description	(Post CCF and CRM)							
Risk weight / Asset classes	0% Rs. '000	20% Rs. '000	50% Rs. '000	75% Rs. '000	100% Rs. '000	150% Rs. '000	>150% Rs. '000	Total credit exposures amount Rs. '000
Claims on Central Government and CBSL	543,414,224	178,560	–	–	–	–	–	543,592,783
Claims on foreign sovereigns and their central banks	–	–	–	–	–	–	–	–
Claims on public sector entities	–	–	–	–	57,491	–	–	57,491
Claims on official entities and multilateral development banks	–	–	–	–	–	–	–	–
Claims on banks exposures	–	15,234,038	23,480,097	–	6,303,442	–	–	45,017,577
Claims on financial institutions	–	2,018,860	9,741,643	–	1,186,845	–	–	12,947,349
Claims on corporates	–	9,597,155	978,128	–	1,872,723	–	–	12,448,006
Retail claims	29,675,178	4,457	–	125,390,334	–	–	–	155,069,970
Claims secured by residential property	–	–	65,823,559	–	476,088	–	–	66,299,647
Claims secured by commercial real estate	–	–	–	–	–	–	–	–
Non-performing assets (NPAS)	–	–	34,575	–	2,758,149	2,410,766	–	5,203,491
Higher risk categories	–	–	–	–	–	–	–	–
Cash items and other assets	687,697	183,213	–	–	19,572,941	–	–	20,443,850
Total	573,777,099	27,216,283	100,058,003	125,390,334	32,227,679	2,410,766	–	861,080,161

Basel III Disclosures as per Schedule III of Banking Act Direction No. 1 of 2016

Market Risk under Standardised Measurement Method

Item	Bank RWA Amount as at 31.12.2018 Rs. '000	Group RWA Amount as at 31.12.2018 Rs. '000
(a) RWA for interest rate risk	6,490,904	9,918,163
General Interest Rate Risk	6,490,904	9,918,163
(i) Net long or short position	6,490,904	9,918,163
(ii) Horizontal disallowance	–	–
(iii) Vertical disallowance	–	–
(iv) Options	–	–
Specific interest rate risk	–	–
(b) RWA for equity	3,659,542	3,664,051
(i) General Equity Risk	1,954,061	1,956,728
(ii) Specific Equity Risk	1,705,481	1,707,323
(c) RWA for Foreign Exchange and Gold	1,249,687	1,249,687
Capital charge for market risk [(a)+(b)+(c)] *CAR	1,467,767	1,909,607

Operational Risk under Basic Indicator Approach

Bank

Capital Charge	Capital Charge Factor %	Gross income as at 31.12.2018 1st year Rs. '000	2nd year Rs. '000	3rd year Rs. '000	Rs. '000
The basic indicator approach	15	26,227,552	27,981,561	26,157,586	
Capital charge	–	–	–	–	4,018,335
Risk weighted amount for operational risk	–	–	–	–	31,210,369

Group

Capital Charge	Capital Charge Factor %	Gross income as at 31.12.2018 1st year Rs. '000	2nd year Rs. '000	3rd year Rs. '000	Rs. '000
The basic indicator approach	15	26,333,652	28,423,674	26,174,478	
Capital charge	–	–	–	–	4,046,590
Risk weighted amount for operational risk	–	–	–	–	31,429,825

Basel III Disclosures as per Schedule III of Banking Act Direction No. 1 of 2016

Differences between Accounting and Regulatory Scopes and Mapping of Financial Statement Categories with Regulatory Risk Categories

Bank

As at 31 December 2018	a	b	c	d	e
	Carrying values as reported in Published Financial Statements Rs. '000	Carrying values under Scope of Regulatory Reporting Rs. '000	Subject to Credit Risk Framework Rs. '000	Subject to Market Risk Framework Rs. '000	Not subject to Capital Requirements or subject to Deduction from Capital Rs. '000
Assets	**1,037,482,973**	**1,039,232,187**	**852,803,563**	**18,545,598**	**167,883,025**
Cash and cash equivalents	3,434,524	5,786,129	3,405,984	22,905	2,357,240
Balances with Central Bank	–	–	–	–	–
Placements with banks	17,588,445	17,151,588	17,151,588	–	–
Derivative financial instruments	4,740,106	–	–	–	–
Financial assets recognised through profit or loss measured at fair value/ other financial assets held for trading	16,680,382	21,832,386	–	18,522,693	3,309,693
Financial assets designated at fair value through profit or loss	–	–	–	–	–
Financial assets at amortised cost:					
Loans and receivables to banks	24,326,293	22,805,186	22,805,186	–	–
Loans and receivables to other customers	399,205,852	401,317,886	243,481,272	–	157,836,614
Debt and other instruments/financial investments held to maturity	518,947,969	503,953,872	501,532,305	–	2,421,567
Financial assets measured at fair value through OCI/financial investments available for sale	6,184,430	–	–	–	–
Investments in subsidiaries	1,700,000	1,700,000	318,163	–	1,381,837
Investments in associates and joint ventures	–	–	–	–	–
Property, plant and equipment	13,465,755	12,889,681	12,889,681	–	–
Investment properties	–	–	–	–	–
Intangible assets	–	576,075	–	–	576,075
Deferred tax assets	–	–	–	–	–
Other assets	31,209,216	51,219,384	51,219,384	–	–

Basel III Disclosures as per Schedule III of Banking Act Direction No. 1 of 2016

Differences between Accounting and Regulatory Scopes and Mapping of Financial Statement Categories with Regulatory Risk Categories (Contd.)

Bank (Contd.)

As at 31 December 2018	a	b	c	d	e
	Carrying values as reported in Published Financial Statements Rs. '000	Carrying values under Scope of Regulatory Reporting Rs. '000	Subject to Credit Risk Framework Rs. '000	Subject to Market Risk Framework Rs. '000	Not subject to Capital Requirements or subject to Deduction from Capital Rs. '000
Liabilities	993,750,308	990,648,134	–	–	–
Due to banks	77,119,146	76,883,763	–	–	–
Derivative financial instruments	1,533	–	–	–	–
Financial liabilities recognised through profit	–	–	–	–	–
Financial liabilities at amortised cost:					
– Due to other customers	839,574,411	813,905,714	–	–	–
– Due to debt securities holders	–	–	–	–	–
– Due to other borrowers	14,804,802	14,592,473	–	–	–
Debt securities issued	46,382,722	45,651,444	–	–	–
Retirement benefit obligations	3,830,795	–	–	–	–
Current tax liabilities	–	–	–	–	–
Deferred tax liabilities	582,463	582,463	–	–	–
Other provisions	–	–	–	–	–
Other liabilities	5,447,277	33,032,277	–	–	–
Due to subsidiaries	750	750	–	–	–
Subordinated term debt	6,006,411	6,000,000	–	–	–
Off-balance sheet liabilities	4,481,398	45,290,790	2,246,703	–	–
Guarantees	1,887,763	1,887,763	–	–	–
Performance bonds	–	–	–	–	–
Letters of credit	277,937	277,937	134,890	–	–
Other contingent items	–	–	–	–	–
Undrawn loan commitments	1,579,548	1,579,548	559,476	–	–
Other commitments	736,149	41,545,541	1,552,337	–	–
Shareholders' equity	9,400,000	9,400,000	–	–	–
Equity capital (stated capital)/ assigned capital	–	–	–	–	–
of which amount eligible for CET 1	9,400,000	9,400,000	–	–	–
of which amount eligible for AT 1	–	–	–	–	–
Retained earnings	4,622,080	–	–	–	–
Accumulated other comprehensive income	528,430	–	–	–	–
Other reserves	29,182,155	39,184,053	–	–	–
Total shareholders' equity	43,732,665	48,584,053	–	–	–

Explanations of Differences between Accounting and Regulatory Exposure Amounts (Bank)

The carrying value of loans and advances in the published Financial Statements has been subject to impairment provisions based on the principles of "expected credit loss" as per SLFRS 9 (Refer Note 21 of the Financial Statements for details) while the carrying value of regulatory reporting is as per the Banking Act Direction No. 4 of 2008 on "Classification of Loans and Advances, Income Recognition and Provisioning" issued by the CBSL are "time/delinquency based". Bank assess the impairment of loans and advances individually or collectively. The impairment allowance is based on the credit losses expected to arise by considering the change in the risk of default occurring over the remaining life of the financial instrument.

As per the Banking Act Direction on the prudential norms for classification, valuation and operation of the Bank's investment portfolio, Financial assets recognised through profit or loss – measured at fair value and Financial assets measured at fair value through OCI are classified as Held for trading under regulatory reporting and accrued interest classified under other assets category. Financial assets at amortised cost – debt and other instruments are classified as Held to maturity investments (Banking Book) under regulatory reporting and accrued interest classified under other assets category. The "Fair value" is defined as the best estimate of the price that would be received to sell an asset or be paid to transfer a liability in an orderly transaction between market participants at the measurement date. A variety of valuation techniques combined with the range of plausible market parameters as at a given point in time may still generate unexpected uncertainty beyond fair value. Refer Note 55 of the Financial Statements for details on valuation methodologies.

Further, all financial instruments except equity considered in regulatory reporting differs with the published Financial Statements since impairment allowances based on expected losses under SLFRS 9 were netted off for publication purposes.

A "Day 1 difference" is recognised as per SLFRS 9 in contrary to regulatory reporting, when the transaction price differs from the fair value of other observable current market transactions in the same instrument E.g. Employee loans below market rates.

Derivatives are financial instruments which derive values in response to changes in interest rates, financial instrument prices, commodity prices, foreign exchange rates, credit risk and indices. The fair value of these derivative financial instruments is determined using forward pricing models. The positive fair value changes of these financial instruments as at reporting date are reported as assets while the negative fair value changes are reported as liabilities. The details of derivative financial instruments have been disclosed in Note 19 to the Financial Statements. Derivatives are disclosed under off-balance sheet in the regulatory reporting.

Bank's Risk Management Approach and Risk Management Related to Key Risk Exposures

Bank's Risk Management Approach and Risk Management Related to Key Risk Exposures are explained in Risk Management Report on page 194 to 226.

Other Disclosure Requirements as required by CBSL

Disclosure requirements under the prescribed format issued by the Central Bank of Sri Lanka for preparation of Annual Financial Statements of licensed specialised banks.

Disclosure requirements		Description	Page number/s
1.	**Information about the significance of financial instruments for financial position and performance**		
1.1	**Statement of financial position**		
1.1.1	Disclosures on categories of financial assets and financial liabilities.	Notes to the Financial Statements:	
		Note 15 – Analysis of financial instruments by measurement basis	289-291
1.1.2	Other disclosures		
	i. Special disclosures about financial assets and financial liabilities designated to be measured at fair value through profit or loss, including disclosures about credit risk and market risk, changes in fair values attributable to these risks and the methods of measurement.	Significant accounting policies:	
		Note 2.5.1.4.5 Financial assets measured at fair value through profit or loss (FVPL)	265
		Note 2.5.1.5.1 Financial liabilities at fair value through profit or loss (FVPL)	266
	ii. Reclassifications of financial instruments from one category to another.	Significant accounting policies:	
		Note 2.5.1.7 Reclassification of financial assets and liabilities	267-268
	iii. Information about financial assets pledged as collateral and about financial or non-financial assets held as collateral.	Notes to the Financial Statements:	
		Note 22 – Financial assets at amortised cost – Debt and other instruments	304-305
	iv. Reconciliation of the allowance account for credit losses by class of financial assets.	Note 16 – Cash and cash equivalent	292
		Note 18 – Placement with banks	292
		Note 21 (d) – Movement in impairment during the year (Loan and advances)	301
		Note 22 (b) – Movement in impairment during the year (debt and other instruments)	305
	v. Information about compound financial instruments with multiple embedded derivatives.	The Bank does not have financial instruments with multiple embedded derivatives	
	vi. Breaches of terms of loan agreements.	None	
1.2	**Statement of comprehensive income**		
1.2.1	Disclosures on items of income, expense, gains and losses	Notes to the Financial Statements:	
		Notes 3-13 to the Financial Statements	277-287
1.2.2	Other disclosures		
	i. Total interest income and total interest expense for those financial instruments that are not measured at fair value through profit and loss.	Notes to the Financial Statements:	
		Note 4 – Net interest income	277-279
	ii. Fee income and expense.	Notes to the Financial Statements:	
		Note 5 – Net fee and commission income	279-280

Other Disclosure Requirements as required by CBSL

	Disclosure requirements	Description	Page number/s
	iii. Amount of impairment losses by class of financial assets.	Notes to the Financial Statements: Note 10 – Impairment charges	283
	iv. Interest income on impaired financial assets.	Notes to the Financial Statements: Note 4 (a) Net interest income	278
1.3	**Other disclosures**		
1.3.1	Accounting policies for financial instruments.	Note 2.5 – Significant accounting policies – recognition of assets and liabilities Financial instruments	263
1.3.2	Information on financial liabilities designated at FVPL.	The Bank/Group has not designated any financial liability at FVPL. Notes to the Financial Statements: Note 2.5.1.5.1 – Financial liabilities at fair value through profit or loss	266
1.3.3	Investments in equity instruments designated at FVOCI		
	i. Details of equity instruments that have been designated as at FVOCI and the reasons for the designation.	Notes to the Financial Statements: Note 23 – Financial assets at fair value through other comprehensive income	305-309
	ii. Fair value of each investment at the reporting date.	Notes to the Financial Statements: Note 23 (e) – Quoted investments – Equity securities Note 23 (f) – Unquoted investments – Equity securities	308 309
	iii. Dividends recognised during the period, separately for investments derecognised during the reporting period and those held at the reporting date.	Notes to the Financial Statements: Note 9 – Net other operating income	282
	iv. Transfer cumulative gain or loss within equity during the period and the reasons for those transfers.	Income Statement, Statement of Other Comprehensive Income and Statement of Changes in Equity	248-254
	v. If investments in equity instruments measured at FVOCI are derecognised during the reporting period: – reasons for disposing of the investments – fair value of the investments at the date of derecognition – the cumulative gain or loss on disposal	Income Statement, Statement of Other Comprehensive Income and Statement of Changes in Equity	248-254
1.3.4	Reclassification of financial assets		
	i. For all reclassifications of financial assets in the current or previous reporting period: – date of reclassification – detailed explanation of the change in the business model and a qualitative description of its effect on the financial statements – the amount reclassified into and out of each category	Notes to the Financial Statements: Note 52 – Explanation of transition to Sri Lanka financial reporting standards (SLFRS 09)	342

Other Disclosure Requirements as required by CBSL

	Disclosure requirements	Description	Page number/s
	ii. For reclassifications from FVTPL to amortised cost or FVOCI: – the effective interest rate (EIR) determined on the date of reclassification – the interest revenue recognised	During the period, the Bank has not classified financial instruments from FVOCI to amortised cost	
	iii. For reclassifications from FVOCI to amortised cost, or from FVTPL to amortised cost or FVOCI: – The fair value of the financial assets at the reporting date – The fair value gain or loss that would have been recognised in profit or loss or OCI during the reporting period if the financial assets had not been reclassified.	During the period, the Bank has not classified financial instruments from FVPL to amortised cost or FVOCI	
1.3.5	Information on hedge accounting	Notes to the Financial Statements:	
		Note 19 – Derivative financial instruments	293-295
1.3.6	Information about the fair values of each class of financial asset and financial liability, along with:		
	i. Comparable carrying amounts.	Notes to the Financial Statements:	378-379
		Note 55.4 – Fair value of financial instruments	
	ii. Description of how fair value was determined.	Notes to the Financial Statements:	
		2.1.12.2 – Fair value of financial instruments	260
		2.3 – Fair value measurement	262
		Note 55.2 – Determination of fair value and fair value hierarchy	375-377
		Note 55.5 Determination of fair value	379-380
	iii. The level of inputs used in determining fair value.	Notes to the Financial Statements:	
		Note 55 – Fair value of financial instruments	375-380
	iv. a. Reconciliations of movements between levels of fair value measurement hierarchy.	No movements between levels of fair value hierarchy during the year	
	b. Additional disclosures for financial instruments that fair value is determined using level 3 inputs.	Note 55.3 – Reconciliation of movements between levels of fair value measurement hierarchy	378
	v. Information if fair value cannot be reliably measured.	Notes to the Financial Statements:	
		Note 23 (f) – Unquoted investments – equity securities	309
		Note 55.5 – Determination of fair value	379-380
2.	**Information about the nature and extent of risks arising from financial instruments**		
2.1	**Qualitative disclosures.**		
2.1.1	Risk exposures for each type of financial instrument.	Notes to the Financial Statements:	
		Note 53 – Financial risk management	355-372
		Risk management report	194-226

Other Disclosure Requirements as required by CBSL

Disclosure requirements		Description	Page number/s
2.1.2	Management's objectives, policies, and processes for managing those risks.	Notes to the Financial Statements:	
		Note 53 – financial risk management	355-372
		Risk management report	194-226
2.1.3	Changes from the prior period.	No major policy changes during the period under review	
2.2	Quantitative disclosures.		
2.2.1	Summary of quantitative data about exposure to each risk at the reporting date.	Notes to the Financial Statements:	
		Note 53 – Financial risk management	355-372
		Risk management report	194-226
2.2.2	Disclosures about credit risk, liquidity risk, market risk, operational risk, interest rate risk and how these risks are managed.		
	i. Credit risk		
	(a) Maximum amount of exposure (before deducting the value of collateral), description of collateral, information about credit quality of financial assets that are neither past due nor impaired and information about credit quality of financial assets.	Notes to the Financial Statements:	
		Note 53.1.1 – Credit quality analysis	355-361
	(b) For financial assets that are past due or impaired, disclosures on age, factors considered in determining as impaired and the description of collateral on each class of financial asset.	Notes to the Financial Statements:	
		Note 53.1.1 – Credit quality analysis	355-361
	(c) Information about collateral or other credit enhancements obtained or called.	Notes to the Financial Statements:	
		Note 53.1.1. (b) – Management of the credit portfolio	357-359
	(d) Credit risk management practices:	Notes to the Financial Statements:	
	– CRM practices and how they relate to the recognition and measurement ECL, including the methods, assumptions and information used to measure ECL.	Note 2.5.2.2.3 – Overview of the ECL principles	270
		Note 10 – Impairment charges	283
	– Quantitative and qualitative information to evaluate the amounts in the Financial Statements arising from ECL, including changes and the reasons for those changes.	Note 10 – Impairment charges	283
	– How the Bank determines whether the credit risk of financial instruments has increased significantly since initial recognition	Note 2.5.2.2.7 – Significant increase in credit risk	272
	– The Bank's definitions of default for different financial instruments, including the reasons for selecting those definitions.	Note 2.5.2.2.8 – Definition of default and credit impaired assets	272
	– How instruments are grouped if ECL are measured on a collective basis.	Note 10 – Impairment charges	283
	– How the bank determines that financial assets are credit-impaired.	Note 2.5.2.2 – Impairment of financial assets (Policy applicable from 1 January 2019)	270
	– The Bank's write-off policy, including the indicators that there is no reasonable expectation of recovery.	Note 21 (d) – Movements in impairment during the year	301

Other Disclosure Requirements as required by CBSL

Disclosure requirements	Description	Page number/s
– How the modification requirements have been applied.	Note 2.5.1.9 – Modification of financial assets and financial liabilities	269
(e) ECL calculations:		
– Basis of the inputs, assumptions and the estimation techniques used when estimating ECL.	Note 2.5.2.2.4 – The calculation of ECL	271
– How forward-looking information has been incorporated into the determination of ECL.	Note 2.5.2.2.6 – Forward looking information	272
– Changes in estimation techniques or significant assumptions made during the reporting period.	Note 2.2 – Changes in accounting policies and transitional disclosures on adoption of SLFRS – 09 in replacement of LKAS 39	261
(f) Amounts arising from ECL:		
– Reconciliation for each class of financial instrument of the opening balance to the closing balance of the impairment loss allowance.	Note 16 – Cash and cash equivalent	292
	Note18 – Placement with banks	292
	Note 21 (d) – Movement in impairment during the year (Loan and advances)	301
– Explain the reasons for changes in the loss allowances in the reconciliation.	Note 22 (b) – Movement in impairment during the year (debt and other instruments)	305
(g) Collateral:	Notes to the Financial Statements:	
– Bank's maximum exposure to credit risk at the reporting date	Note 53.1.1 (a) – Net exposure to Credit risk by class of financial assets	355-357
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ii. Liquidity risk		
(a) A maturity analysis of financial liabilities.	Notes to the Financial Statements:	
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(c) Pillar III disclosures of the Banking Act Direction No. 1 of 2016 on capital requirements under Basel III for Licensed Banks	Risk management report	194-226

Other Disclosure Requirements as required by CBSL

Disclosure requirements	Description	Page number/s
iii. Market risk		
(a) A sensitivity analysis of each type of market risk to which the Bank exposed.	Notes to the Financial Statements:	
	Note 53.3 – Market risk	364-366
	Risk management report	194-226
(b) Additional information, if the sensitivity analysis is not representative of the Bank's risk exposure.	Risk management report	194-226
(c) Pillar III disclosures of the Banking Act Direction No. 1 of 2016 on Capital requirements under Basel III for Licensed Banks	Risk management report	194-226
iv. Operational risk		
Pillar III disclosures of the Banking Act Direction No. 1 of 2016 on capital requirements under Basel III for Licensed Banks	Risk management report	194-226
v. Equity risk in the banking book		
(a) Qualitative disclosures:		
→ Differentiation between holdings on which capital gains are expected and those taken under other objectives including for relationship and strategic reasons.	Notes to the Financial Statements:	
	Note 23 – Financial assets at fair value through other comprehensive income	305-309
→ Discussion of important policies covering the valuation and accounting of equity holdings in the banking book.	Notes to the Financial Statements:	
	Note 23 – Financial assets at fair value through other comprehensive income	305-309
(b) Quantitative disclosures:		
→ Value disclosed in the statement of financial position of investments, as well as the fair value of those investments; for quoted securities, a comparison to publicly quoted share values where the share price is materially different from fair value.	Notes to the Financial Statements:	
	Note 20 – Financial assets recognised at through profit or loss	296-299
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→ The types and nature of investments		
→ The cumulative realised gains/(losses) arising from sales and liquidations in the reporting period.	Notes to the Financial Statements:	
	Note 6 – Net Gain/(loss) from trading	281
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vi. Interest rate risk in the banking book		
(a) Qualitative disclosures:		
→ Nature of interest rate risk in the banking book (IRRBB) and key assumptions	Notes to the Financial Statements:	
	Note 53 – Financial risk management	355-372
	Risk management report	194-226

Other Disclosure Requirements as required by CBSL

	Disclosure requirements	Description	Page number/s
	(b) Quantitative disclosures:		
	→ The increase/(decline) in earnings or economic value (or relevant measure used by Management) for upward and downward rate shocks according to Management's method for measuring IRRBB, broken down by currency (as relevant).	Risk management report	194-226
2.2.3	Information on concentrations of risk	Notes to the Financial Statements:	
		Note 53 Financial risk management	355-372
		Risk Management Report	194-226
3.	**Other disclosures**		
3.1	**Capital structure**		
	i. Qualitative disclosures		
	→ Summary information on the terms and conditions of the main features of all capital instruments, especially in the case of innovative, complex or hybrid capital instruments.	Basel III Disclosures as per schedule III of Banking Act Direction No. 1 of 2016	389-401
		Risk management report	194-226
	ii. Quantitative disclosures		
	(a) The amount of Tier 1 capital, with separate disclosure of –	Basel III Disclosures as per schedule III of Banking Act Direction No. 1 of 2016	389-401
	→ Paid-up share capital/common stock		
	→ Reserves		
	→ Non-controlling interests in the equity of subsidiaries		
	→ Innovative instruments		
	→ Other capital instruments		
	→ Deductions from Tier 1 capital		
	(b) The total amount of Tier 2 and Tier 3 capital		
	(c) Other deductions from capital		
	(d) Total eligible capital		
3.1.2	Capital adequacy		
	i. Qualitative disclosures		
	→ A summary discussion of the Bank's approach to assessing the adequacy of its capital to support current and future activities.	Risk management report	194-226
	ii. Quantitative disclosures		
	(a) Capital requirements for credit risk, market risk and operational risk.	Risk management report	194-226
	(b) Total and Tier 1 capital ratio.	Risk management report	194-226

Statistical Indicators 2009-2018

	2009	2010	2011	2012	2013	2014	2015	2016	2017	**2018**
Operating results (Rs. Mn.)										
Gross income	49,803	50,070	46,545	52,903	65,573	77,890	79,282	87,399	107,996	**111,902**
Interest income	49,046	48,142	47,096	52,531	64,248	74,023	78,128	86,390	103,579	**110,507**
Interest expenses	36,067	31,487	29,296	39,142	54,141	52,642	51,146	60,923	78,445	**85,622**
Net interest income	12,979	16,655	17,800	13,389	10,107	21,380	26,983	25,467	25,134	**24,885**
Other income	757	1,929	(578)	347	1,292	3,798	1,043	872	4,308	**1,254**
Operating expenses, provisions and VAT	6,792	8,807	7,967	7,396	9,120	14,706	14,991	13,036	15,307	**18,197**
Profit before tax	6,943	9,777	9,255	6,340	2,279	10,472	13,034	13,303	14,135	**7,941**
Income tax	3,229	4,386	3,193	2,578	1,095	3,606	4,361	3,805	4,419	**3,441**
Profit after tax	3,714	5,391	6,062	3,763	1,184	6,867	8,672	9,498	9,716	**4,500**
Contribution to the Government	7,277	10,107	7,970	6,327	4,731	11,043	11,016	19,251	13,440	**7,536**
ASSETS (Rs. Mn.)										
Cash and short-term funds	855	1,355	1,398	1,466	1,546	1,927	3,240	4,620	3,850	**3,435**
Loans and investments	335,520	395,334	455,914	492,009	632,187	757,182	821,494	878,046	969,036	**989,373**
Property, plant and equipment	3,584	4,971	5,247	5,264	5,692	5,594	7,025	7,277	12,396	**13,466**
Other assets	14,463	2,733	3,415	10,075	14,943	14,764	16,320	21,761	25,696	**31,209**
Total	354,422	404,393	465,974	508,813	654,368	779,466	848,079	911,704	1,010,977	**1,037,483**
Liabilities and shareholders' funds (Rs. Mn.)										
Total deposits	313,007	364,430	421,849	457,650	501,890	554,060	595,776	657,280	737,213	**839,574**
Repo/borrowings/ subordinated liabilities	8,730	11,436	16,270	22,958	120,561	191,192	207,101	213,162	224,143	**144,313**
Differed taxation	84	27	96	123	143	270	504	416	507	**582**
Other liabilities	14,841	5,997	4,707	4,314	9,557	10,684	12,274	8,600	10,019	**9,280**
Shareholders' funds	17,760	22,503	23,052	23,767	22,217	23,260	32,424	32,246	39,096	**43,733**
Total	354,422	404,393	465,974	508,813	654,368	779,466	848,079	911,704	1,010,977	**1,037,483**

Statistical Indicators 2009-2018

	2009	2010	2011	2012	2013	2014	2015	2016	2017	**2018**
RATIOS (%)										
Income growth	20.74	0.54	(7.04)	13.66	23.95	18.78	1.79	10.24	23.57	**3.62**
Interest margin	4.0	4.4	4.1	2.7	1.7	3.0	3.3	2.89	2.61	**2.43**
NIM/Gross income	26.1	33.3	38.2	25.3	15.4	27.4	34.0	29.14	23.27	**22.24**
Personnel cost/gross income	6.9	7.4	8.9	7.7	6.4	6.2	7.5	7.13	6.38	**8.28**
Overheads(excluding prov.)/ gross income	10.7	12.0	13.5	12.0	10.9	11.9	13.3	11.99	10.33	**12.72**
Profit before tax/ gross income	13.9	19.5	19.9	12.0	3.5	13.4	16.4	15.22	13.09	**7.10**
Contribution to the GOSL/gross income	14.6	20.2	17.1	12.0	7.2	14.2	13.9	22.03	12.44	**6.73**
Cost to deposits	2.7	2.7	2.0	1.7	1.6	2.1	2.3	2.12	2.10	**2.22**
Cost to income with VAT	55.5	48.9	45.4	52.8	67.7	44.8	46.1	50.13	49.58	**66.47**
Cost to income without VAT	38.8	32.4	36.4	46.1	62.2	36.7	37.4	39.59	37.75	**54.18**
Return on average shareholder’s funds (ROE)	22.7	27.3	26.61	16.07	5.15	30.20	31.15	29.37	27.24	**10.87**
Return on average assets (ROA)	2.1	2.6	2.13	1.30	0.39	1.46	1.60	1.51	1.47	**0.78**
NPL (gross)	3.80	2.55	2.57	2.38	6.54	7.61	3.46	1.55	1.34	**1.44**
NPL (net)	3.00	1.80	1.93	1.78	6.66	7.56	3.35	1.47	1.22	**1.22**
Capital Adequacy – Tier 1 (minimum 5%)	25.1	22.2	20.10	20.40	18.50	20.46	17.90	12.53	–	**–**
Capital Adequacy – Total (minimum 10%)	21.5	19.2	17.70	19.10	16.72	18.98	16.40	14.68	–	**–**
Basel III – Tier 1 (minimum 8.875%)	–	–	–	–	–	–	–	11.31	11.93	**13.33**
Basel III – Total (minimum 12.875%)	–	–	–	–	–	–	–	13.86	15.31	**16.14**
All currency liquidity coverage ratio (minimum 90%)	–	–	–	–	–	–	445.88	393.96	376.18	**321.29**
Deposits as % of assets	88.3	88.0	90.5	89.9	76.7	71.1	70.3	72.1	72.9	**80.9**
Profit per employee (Rs. ’000)	2,382	3,205	2,826	2,026	774	3,119	3,585	3,034	3,162	**1,760**
Deposit per employee (Rs. ’000)	107,378	116,513	128,809	146,261	170,537	164,997	163,855	149,927	164,925	**186,076**
Other information (Nos.)										
Number of employees	2,915	3,050	3,275	3,129	2,943	3,358	3,636	4,384	4,470	**4,512**
Number of branches	157	186	210	219	229	236	245	250	253	**255**
Post offices/sub post offices	4,055	4,053	4,058	4,053	4,063	4,063	4,063	4,061	4,062	**4,062**
Account holders (Mn.)	16.3	16.7	17.0	17.4	17.9	18.3	18.8	19.3	19.9	**20.4**

*Note:

Highlighted information is based on LKASs/SLFRSs.

2017 figures restated according to the SLFRS 9.

Analysis of Deposits

	2009 Rs. Mn.	2010 Rs. Mn.	2011 Rs. Mn.	2012 Rs. Mn.	2013 Rs. Mn.	2014 Rs. Mn.	2015 Rs. Mn.	2016 Rs. Mn.	2017 Rs. Mn.	**2018 Rs. Mn.**
Local currency deposits										
Savings	79,280	94,118	105,108	106,177	113,165	139,384	160,814	173,583	185,201	**194,946**
Time	230,147	266,007	311,569	345,794	379,969	408,309	427,588	475,220	542,647	**633,632**
	309,427	360,125	416,677	451,971	493,134	547,692	588,402	648,803	727,849	**828,579**
Growth (%)	20.2	13.5	15.7	8.5	9.1	11.1	7.4	10.3	12.2	**13.8**
Foreign currency deposits										
Savings	1,255	1,517	1,750	1,963	2,101	2,215	2,568	2,764	2,990	**3,376**
Time	2,325	2,788	3,422	3,717	6,654	4,153	4,806	5,714	6,373	**7,620**
	3,580	4,305	5,172	5,679	8,755	6,368	7,373	8,478	9,364	**10,996**
Growth (%)	67.3	20.3	20.1	9.8	54.2	-27.3	15.8	15.0	10.5	**17.4**
Total deposits	313,007	364,430	421,849	457,650	501,890	554,060	595,776	657,280	737,213	**839,574**
Growth (%)	20.6	13.5	15.8	8.5	9.7	10.4	7.5	10.3	12.2	**13.9**

*Note: Highlighted information is based on LKASs/SLFRSs.

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Glossary of Financial and Banking Terms

A

Accounting policies

The specific principles, bases, conventions, rules and practices adopted by an entity in preparing and presenting Financial Statements.

Accrual basis

Recognising the effects of transactions and other events when they occur without waiting for receipt or payment of cash or its equivalent.

Actuarial gain

Gain or loss arising from the difference between estimates and actual experience in an entity's pension plan.

Amortisation

The systematic allocation of the depreciable amount of an intangible asset over its useful life.

Amortised cost

Amount at which the financial asset or financial liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount and minus any reduction for impairment or uncollectability.

Available-for-sale financial assets

Available-for-sale financial assets are those non-derivative financial assets that are designated as available-for sale or are not classified as loans and receivables, held-to-maturity investments or financial assets at fair value through profit or loss.

B

Basel III

Basel III is the global voluntary regulatory framework issued by the Basel Committee on Banking Supervision (BCBS) on Bank Capital Adequacy and Liquidity.

Basis point (BP)

One hundredth of a percentage point (0.01 per cent); 100 basis points is 1 percentage point. Used in quoting movements in interest rates or yields on securities.

Business model assessment

Business model assessment is carried out as the first step of the financial assets classification process. Business model refers to how an entity manages its financial assets in order to generate cash flows. It is determined at a level that reflects how groups of financial assets are managed rather than at an instrument level. SLFRS 9 identifies three types of business models: "hold to collect", "hold to collect and sell" and "other". In order to determine the business model, it is necessary to understand the objectives of each business model. An entity would need to consider all relevant information including, for example, how business performance is reported to the entity's Key Management personnel and how Managers of the business are compensated.

C

Capital adequacy ratio

The relationship between capital and risk-weighted assets as defined in the framework developed by the Bank for International Settlements (BIS) and as modified by the Central Bank of Sri Lanka to suit local requirements.

Capital conservation buffer (CCB)

A capital buffer prescribed by regulators under Basel III and designed to ensure banks build up capital buffers outside periods of stress that can be drawn down as losses are incurred. Should a bank's capital levels fall within the capital conservation buffer range, capital distributions will be constrained by the regulators

Capital expenditure

Total of additions to property, plant and equipment.

Capital gain (capital profit)

The gain on the disposal of an asset calculated by deducting the cost of the asset from the proceeds received on its disposal.

Capital reserves

Capital reserves consist of revaluation reserves arising from revaluation of properties owned by the Bank and Reserve Fund set aside for specific purposes defined under the Banking Act No. 30 of 1988 and shall not be reduced or impaired without the approval of the Monetary Board.

Carrying value

Value of an asset or a liability as per books of the Organisation before adjusting for fair value.

Cash Generating Unit (CGU)

The smallest group of assets that independently generates cash flow and the cash flow is largely independent of the cash flows generated by other assets.

Cash equivalents

Short-term highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

Collective agreement

A tripartite agreement entered into among the NSB, Ministry of Finance and Trade Unions.

Collectively assessed loan impairment provisions

Also known as portfolio impairment provisions. Impairment assessment on a collective basis for homogeneous groups of loans that are not considered individually significant and to cover losses that has been incurred but has not yet been identified at the reporting date. Loans (housing, personal, auto loans etc.) are assessed on a portfolio basis.

Commitments

Credit facilities approved but not yet utilised by the clients as at the reporting date.

Concentration risk

Risk arisen from uneven distribution of counterparty and portfolio exposures to business sector or geographic region.

Contingencies

A condition or situation existing at reporting date where the outcome will be confirmed only by occurrence or non-occurrence of one or more future events.

Corporate governance

The process by which corporate entities are governed. It is concerned with the way in which power is exercised over the Management and the direction of entity, the supervision of executive actions and accountability to owners and others.

Cost/income ratio

Operating expenses excluding impairment provision and provisioning for fall in value in dealing securities as a percentage of net income.

Glossary of Financial and Banking Terms

Cost method →
A method of accounting whereby the investment is recorded at cost. The Income Statement reflects income from the investment only to the extent that the investor receives distributions from accumulated net profits of the investee.

Credit ratings →
An evaluation of a corporate's ability to repay its obligation or the likelihood of not defaulting, carried out by an independent rating agency.

Credit risk →
Credit risk or default risk is most simply defined as the potential that a borrower or counterparty will fail to meet its obligations in accordance with agreed terms and conditions.

Currency SWAPs →
The simultaneous purchase of an amount of a currency for spot settlement and the sale of the same amount of the same currency for forward settlement.

Customer deposits →
Money deposited by account holders. Such funds are recorded as liabilities.

D

Dealing securities →
Marketable securities that are acquired and held with the intention of reselling them in the short term.

Debenture →
A medium-term debt instrument issued by a corporate entity.

Deferred tax →
Sum set aside for tax in the Financial Statements that will become payable in a financial year other than the current financial year.

Depreciation →
The systematic allocation of the depreciable amount of an asset over its useful life.

Derecognition →
Removal of previously recognised financial assets or financial liability from an entity's Statement of Financial Position.

Delinquency →
A debt or other financial obligation is considered to be in a state of delinquency when payments are overdue. Loans and advances are considered to be delinquent when consecutive payments are missed. Also known as "Arrears".

Derivative →
Financial contract of which the value is derived from the value of underlined assets.

Documentary letters of credit (LCs) →
Written undertakings by a bank on behalf of its customers, authorising a third party to draw on the Bank up to a stipulated amount under specific terms and conditions. Such undertakings are established for the purpose of facilitating international trade.

Domestic Systemically Important Banks (D-SIBs) →
Systemically Important Banks (SIBs) are perceived as banks that are "Too Big To Fail". D-SIBs are critical for the uninterrupted availability of essential banking services to the country's real economy even during crisis. The CBSL has designated LCBs with total assets equal to or greater than Rs. 500 Bn. as D-SIBs.

E

Earnings per ordinary share (EPS) →
Profit attributable to ordinary shareholders divided by the number of ordinary shares in issue.

Economic value added (EVA) →
A measure of productivity which takes into consideration cost of total invested equity.

Effective income tax rate →
Provision for taxation divided by the profit before taxation

Effective interest rate (EIR) →
Rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instruments or when appropriate a shorter period to the net carrying amount of the financial asset or financial liability.

Equity instrument →
An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all its liabilities.

Equity method →
The equity method is a method of accounting whereby the investment is initially recognised at cost and adjusted thereafter for the post-acquisition changes in the investor's share of net assets of the investee. The profit or loss of the investor includes the investor's share of the profit or loss of the investee.

Equity risk →
Risk of depreciating equity investments due to stock market dynamics.

Exposure at default (EAD) →
EAD 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 principal and interest and expected draw downs of committed facilities.

Expected credit losses (ECLs) →
ECL approach is the loan loss impairment method under SLFRS 9 on "Financial Instruments". ECLs are the discounted product of the Probability of Default (PD), Exposure at Default (EAD) and Loss Given Default (LGD). ECL measurements are unbiased and are determined by evaluating a range of possible outcomes.

Exchange gain/loss →
Profit earned on foreign currency transactions arising from the difference in foreign exchange rates between the transaction/last reporting date and the settlement/ reporting date. Also arises from trading in foreign currencies.

F

Fair value →
The amount for which an asset could be exchanged or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

Financial asset →
Financial asset is any asset that is cash, an equity instrument of another entity or a contractual right to receive cash or another financial asset from another entity.

Glossary of Financial and Banking Terms

Financial assets measured at amortised cost →

A financial asset is measured at amortised cost if the asset is held within a business model whose objective is to hold assets to collect contractual cash flows and the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

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

FVOCI include debt and equity instruments measured at fair value through other comprehensive income.
A debt instrument is measured at FVOCI, if it is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets and the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.
Equity investments may be irrevocably classified as FVOCI when they meet the definition of Equity under LKAS 32 Financial Instruments: Presentation and are not held for trading.

Financial assets measured at fair value through profit or loss (FVPL) →

All financial assets other than those classified at Amortised Cost or FVOCI are classified as measured at FVPL. These are held for trading or managed, and their performance is evaluated on a fair value basis as they are neither held to collect contractual cash flows nor held both to collect contractual cash flows and to sell financial assets.

Financial instrument →

Financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

Financial liability →

Financial Liability is a contractual obligation to deliver cash or another financial asset to another entity.

Foreclosed properties →

Properties acquired in full or partial; satisfaction of debts.

Foreign currency risk →

Risk exists in transaction other than the local currency. Adverse movements in foreign exchange rates may decline the value of assets/liabilities held in terms of foreign currency.

Foreign exchange contract →

Agreement between two parties to exchange one currency for another at a future date at a rate agreed upon today.

G

General provisions →

These are provisions made on loans and advances for anticipated losses on aggregate exposures where credit losses cannot yet be determined on an individual facility basis.

Group →

A group is a parent and all its subsidiaries.

Guarantees →

Three party agreement involving a promise by one party (the guarantor) to fulfil the obligations of a person owing a debt if that person fails to perform.

Global Reporting Initiatives (GRI) →

The GRI is an international independent standards organisation that helps businesses, governments and other organisations to understand and communicate their impacts on issues such as climate change, human rights and corruption. GRI promotes sustainability reporting as a way for organisations to become more sustainable and contribute to sustainable development.

H

Hedging →

A strategy under which transactions are effected with the aim of providing cover against the risk of unfavourable price movements (interest rates and prices of commodities etc.).

Held-to-maturity investments (HTM) →

Non-derivative financial assets with fixed or determinable payments and fixed maturity that an entity has the positive intention and ability to hold to maturity.

Held-for-trading (HFT) →

Debt and equity investments that are purchased with the intent of selling them within a short period of time (usually less than one year).

High quality liquid assets (HQLA) →

Assets that are unencumbered, liquid in markets during a time of stress and, ideally, be central bank eligible. These include, for example, cash and claims on central governments and central banks.

I

ICCAP →

Process by which the Bank ensures additional capital is provided for banking risks other than those covered in Pillar.

Impairment →

This occurs when recoverable amount of an asset is less than its carrying amount.

Impaired assets portfolio →

Impaired assets portfolio is the total of the individually significant impaired loans and individually insignificant loans which are overdue above 180 days.

Impairment allowances →

Impairment allowances are provisions held on the Statement of Financial Position as a result of the raising of a charge against profit for the incurred loss. An impairment allowance may either be identified or unidentified as individual (specific) or collective (portfolio) impairment allowance.

Impairment charge/ (reversal) →

the difference between the carrying value of an asset and the sum of discounted future cash flows generating from the same asset.

Impaired loans →

Loans where the Group does not expect to collect all the contractual cash flows or expects to collect them later than they are contractually due.

Individually assessed impairment →

Exposure to loss is assessed on all individually significant accounts and all other accounts that do not qualify for collective assessment.

Glossary of Financial and Banking Terms

Intangible asset →
An asset that is not physical in nature. Corporate intellectual property (items such as patents, trademarks, copyrights, business methodologies), goodwill software and brand recognition are all common intangible assets in today's marketplace.

Interest in suspense →
Interest suspended on non-performing loans and advances.

Interest rate risk →
The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

Interest spread →
Represents the difference between the average interest rate earned and the average interest rate paid on interest earning assets and interest bearing liabilities, respectively. variables such as interest rates, exchange rates, credit spreads and other asset prices.

Investment properties →
Investment property is property (land or a building – or part of a building – or both) held (by the owner or by the lessee under a finance lease) to earn rentals or for capital appreciation or both, rather than for use or sale.

Investment securities →
Securities acquired and held for yield or capital growth purposes and are usually held-for-maturity.

Interest rate SWAP →
An agreement between two parties (known as counter parties) where one stream of future interest payments is exchanged for another stream of future interest payments based on a specified principal amount.

K

Key Managerial Personnel (KMP) →
Key managerial personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Bank, directly or indirectly.

L

Leverage ratio →
A measure that is the ratio of tier 1 capital to total exposures. This supplementary measure to the risk-based capital requirements is intended to constrain the build-up of excess leverage in the banking sector.

Liquid assets →
Assets that are held in cash or in a form that can be converted to cash readily, such as deposits with other banks, bills of exchange and Treasury Bills.

Liquid assets ratio →
Assets that are held in cash or in a form that can be converted to cash readily (as prescribed by the Central Bank of Sri Lanka) divided by the total liabilities including contingent liabilities.

Lifetime expected credit losses (LTECL) →
Lifetime ECL are the expected credit losses that result from all possible default events over the expected life of the financial instrument. According to SLFRS 9 on "Financial instruments", the ECL allowance should be based on LTECL unless there has been no significant increase in credit risk since origination.

Liquidity coverage ratio – LCR →
Refers to highly liquid assets held by Banks to meet short-term obligations. The ratio represents a generic stress scenario that aims to anticipate market-wide shocks.

Liquidity risk →
The risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities.

Loans and advances →
Conventional loan assets that are unquoted (originated or acquired).

Loss given default (LGD) →
LGD is the percentage of an exposure that a lender expects to loose in the event of obligor default.

Loan-to-value ratio (LTV) →
The LTV ratio is a mathematical expression which expresses the amount of a first mortgage lien as a percentage of the total appraised value of real property. The LTV ratio is used in determining the appropriate level of risk for the loan and therefore the correct price of the loan to the borrower.

M

Market risk →
This refers to the possibility of loss arising from changes in the value of a financial instrument as a result of changes in market variables such as interest rates, exchange rates, credit spreads and other asset prices.

Materiality →
The relative significance of a transaction or an event, the omission or misstatement of which could influence the decisions of users of Financial Statements.

N

Net interest income (NII) →
The difference between the amount a bank earns on assets such as loans and securities and the amount it pays on liabilities such as deposits, refinance funds and inter-bank borrowings.

Net interest margin (NIM) →
The margin is expressed as net interest income divided by average interest earning assets.

Non-performing loans (NPL) →
The loans which are in default for more than three months.

NOSTRO accounts →
A bank account held in foreign country by a domestic bank, denominated in the currency of that country. NOSTRO accounts are used to facilitate the settlement of foreign exchange trade transactions.

NPL ratio →
Total non-performing loans and advances (net of interest in suspense) divided by total loans and advances portfolio (net of interest in suspense).

Net stable funding ratio (NSFR) →
Measures the amount of longer-term, stable sources of funding employed by a bank relative to the liquidity profiles of the assets funded and the potential for contingent calls on funding liquidity arising from off-balance sheet commitments and obligations.

Glossary of Financial and Banking Terms

O

Off-balance sheet transactions
Transactions that are not recognised as assets or liabilities in the Statement of Financial Position, but which give rise to contingencies and commitments.

Operational risk
This refers to the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events including legal risk.

Open credit exposure ratio
Total net non-performing loans and advances expressed as a percentage of regulatory capital base.

P

Parent
A parent is an entity that has one or more subsidiaries.

Portfolio
A pool of investments including investment in Government Securities, loans and advances, equities, etc.

Probability of default (PD)
PD is an internal estimate for each borrower grade of the likelihood that an obligor will default on an obligation.

Provision cover
Total provisions for loan losses expressed as a percentage of net non-performing loans and advances before discounting for provisions on non-performing loans and advances.

Projected Unit Credit Method (PUC)
An actuarial valuation method that sees each period of service as giving rise to an additional unit of benefit entitlement and measures each unit separately to build up the final obligation. Inclusion of a degree of caution in the exercise of judgement needed in making the estimates required under conditions of uncertainty, such that assets or income are not overstated, and liabilities or expenses are not understated.

R

Return on average assets (ROA)
Profit after tax expressed as a percentage of the average assets.

Return on average equity (ROE)
Net profit attributable to owners expressed as a percentage of average ordinary shareholders' equity.

Related parties
Parties where one party has the ability to control the other party or exercise significant influence over the other party in making financial and operating decisions, directly or indirectly.

Related party transaction (RPT)
RPT is a transfer of resources, services or obligations between a reporting entity and a related party, regardless whether a price is charged.

REPOs
Repurchase agreements. Securities sold to lenders with the commitment to buy back on a later date at a fixed price plus interest.

Reverse repurchase agreement
Transaction involving the purchase of securities by a bank or a dealer and resale back to the seller at a future date at a specified price.

Revenue reserve
Reserves set aside for future distribution and investment.

Risk-weighted assets
The sum of assets as per the Statement of Financial Position and the credit equivalent of assets that are not on the Statement of Financial Position multiplied by the relevant risk-weighting factors.

Rupee loan
Rupee securities issued by the Central Bank of Sri Lanka on behalf of the Government of Sri Lanka.

S

Shareholders' funds
A capital reserve created as per the provisions of the Banking Act No. 30 of 1988.

Significant increase in credit risk (SICR)
According to SLFRS 9, an entity should assess whether the risk of default on a financial instrument has increased significantly since initial recognition. The assessment should consider reasonable and supportable information that is relevant and available without undue cost or effort. There is a rebuttable presumption in the Standard that the credit risk on a financial asset has increased significantly since initial recognition when contractual payments are more than 30 days past due.

SPPI Test
Solely Payments of Principal and Interest Test (SPPI) is carried out as the second step of the classification process. "Principal" is defined as the fair value of the financial asset at initial recognition and may change due to repayments of principal or amortisation of the premium or discount. "Interest" is defined as consideration for the time value of money and for the credit risk associated with the principal amount outstanding. If a financial asset passes the SPPI test, then it will either be classified at amortised cost if the "hold to collect" business model test is met, or at Fair Value Through Other Comprehensive Income (FVOCI) if the "hold to collect and sell" business model test is met. If a financial asset fails, the SPPI test it must be classified at Fair Value Through Profit or Loss (FVPL) in its entirety

Statutory reserve fund
A capital reserve created as per the provisions of the Banking Act No. 30 of 1988.

Subordinated liabilities
Liabilities that rank after the claims of other creditors of the issuer in the event of insolvency or liquidation.

Stress test
Integrated test that shows to varying degrees whether the Bank can withstand unforeseen scenarios of varying severity.

Subsidiary
An entity that is controlled by another entity.

Glossary of Financial and Banking Terms

Substance over form →
The consideration that the accounting treatment and the presentation in Financial Statements of transactions and events should be governed by their substance and financial reality and not merely by legal form.

Swaps (currency) →
The simultaneous purchase of an amount of a currency for spot settlement and the sale of the same amount of the same currency for forward settlement. Alternatively, a simultaneous spot sale and forward purchase of a currency.

T

Tier 1 capital →
A component of regulatory capital, comprising common equity Tier 1 and additional Tier 1 capital. Core measure of financial strength of the Bank representing permanent shareholders' equity and reserves created or increased by appropriations of retained earnings or other surpluses.

Tier 2 capital →
Tier 2 capital represents revaluation gains, general provisions and other capital instruments which combine certain characteristics of equity and debt such as subordinated term debts.

Total capital →
Total Capital is summation of the Tier 1 and the Tier 2 capital.

Treasury Bill →
A short-term debt instrument issued on auction basis by the Central Bank of Sri Lanka on behalf of the Government of Sri Lanka.

Treasury Bond →
A long-term debt instrument issued on auction basis by the Central Bank of Sri Lanka on behalf of the Government of Sri Lanka.

Twelve-month expected credit losses (12-Month ECL) →
The portion of lifetime expected credit losses that represent the expected credit losses that result from default events on a financial instrument that are possible within the 12-months after the reporting date.

U

Unit trust →
An undertaking formed to invest in securities under the terms of a trust deed.

Useful life →
Useful life is the period over which an asset is expected to be available for use by an entity or the number of production or similar units expected to be obtained from the asset by an entity.

V

Value added →
Wealth created by providing banking and other services less the cost of providing such services. The value added is allocated among the employees, the providers of capital, to Government by way of taxes and retained for expansion and growth.

Value at risk ("VaR") →
A measure of the loss that could occur on risk positions as a result of adverse movements in market risk factors (e.g. rates, prices, volatilities) over a specified time horizon and to a given level of confidence.

Y

Yield to maturity (YTM) →
Discount rate at which the present value of future cash flows would equal the security' s current price.

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