Notes to the Financial Statements

1. Reporting Entity

1.1 Corporate information

Commercial Bank of Ceylon PLC (the "Bank") is a public limited liability company listed on the Colombo Stock Exchange (CSE), incorporated on June 25, 1969 under the Companies Ordinance No. 51 of 1938, and domiciled in Sri Lanka. It is a licensed commercial bank regulated under the Banking Act No. 30 of 1988 and amendments thereto. The Bank was re-registered under the Companies Act No. 07 of 2007 on January 23, 2008, under the Company Registration No. PQ 116. The registered office of the Bank is situated at "Commercial House", No. 21, Sir Razik Fareed Mawatha, Colombo 01, Sri Lanka.

The ordinary shares of the Bank (both Ordinary Voting and Non-Voting shares) have a primary listing on the CSE. The unsecured subordinated debentures of the Bank are also listed on the CSE.

The staff strength of the Bank as at December 31, 2018 was 5,027 (4,982 as at December 31, 2017).

Corporate information is presented in the inner back cover of this Annual Report.

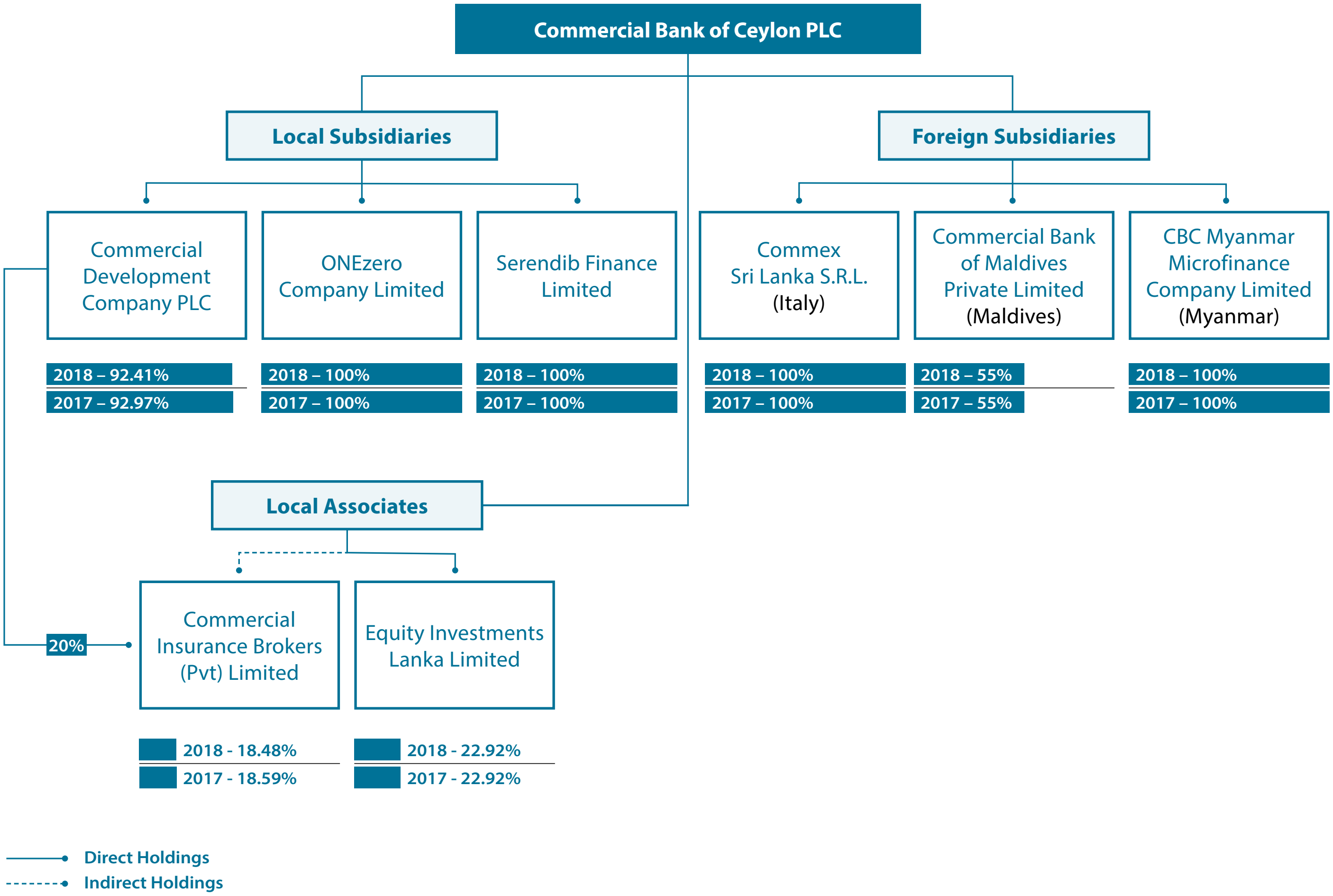
1.2 Consolidated Financial Statements

The Consolidated Financial Statements as at and for the year ended December 31, 2018, comprise the Bank (Parent Company) and its Subsidiaries (together referred to as the "Group" and individually as "Group entities") and the Group's interest in its Associates.

The Bank does not have an identifiable parent of its own. The Bank is the Ultimate Parent of the Group.

1.3 Principal business activities, nature of operations of the Group and ownership by the Bank in its subsidiaries and associates

Group Structure Figure – 33



Principal business activities and nature of business operations of the Group Table – 34

Entity	Principal business activities
Commercial Bank of Ceylon PLC	Banking and related activities such as accepting deposits, personal banking, trade financing, offshore banking, RFC & NRFC operations, travel related services, corporate and retail credit, syndicated financing, project financing, development banking, lease & hire purchase, rural credit, issuing of local and international debit and credit cards, internet banking, mobile banking, money remittance facilities, dealing in Government Securities and treasury related products, salary remittance package, bullion trading, export and domestic factoring, pawning, margin trading, e-Banking services, bancassurance and Islamic banking products and services etc.
Subsidiaries	
Commercial Development Company PLC (CDC)	Property development, related ancillary services and outsourcing of staff for non-critical functions of the Bank (Parent).
ONEzero Company Limited	Providing Information & Communication Technology (ICT) related products, services and solutions to the corporate sector.
Serendib Finance Limited	Providing financial services including leasing, hire purchase loans etc.
Commex Sri Lanka S.R.L.	Operating as an agent to the Bank (parent) for opening accounts, providing money transfer services, issuance and encashment of foreign currencies and travellers cheques, collecting applications for credit facilities and handling of ATM cards etc.
Commercial Bank of Maldives Private Limited	Offering of extensive range of banking and related financial services
CBC Myanmar Microfinance Company Limited	Providing microfinance services to the people of Myanmar. The Company also provides savings, business/livelihood development services for the clients adopting a credit plus approach.
Associates	
Commercial Insurance Brokers (Pvt) Limited (CIB)	Providing professional service and handle all insurance portfolios of individuals as well as many leading and reputed organisations in Sri Lanka engaged in diverse business activities.
Equity Investments Lanka Limited	Providing investment services, risk capital and venture capital management

2. Basis of Accounting

2.1 Statement of compliance

The Consolidated Financial Statements of the Group and the separate Financial Statements of the Bank, have been prepared and presented in accordance with the Sri Lanka Accounting Standards (SLFRSs and LKASs), laid down by The Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka) and in compliance with the requirements of the Companies Act and the Banking Act and provide appropriate disclosures as required by the Listing Rules of the CSE. These Financial Statements, except for information on cash flows have been prepared following the accrual basis of accounting.

These SLFRSs and LKASs are available at www.casrilanka.com

The Group did not adopt any inappropriate accounting treatments, which are not in compliance with the requirements of the SLFRSs and LKASs, regulations governing the preparation and presentation of the Financial Statements.

Details of the Group's Significant Accounting Policies followed during the year are given in Notes 6 to 10 on pages 180 to 195.

The formats used in the preparation and presentation of the Financial Statements and the disclosures made therein also comply with the specified formats prescribed by the Central Bank of Sri Lanka (CBSL) in the Circular No. 02 of 2019 on "Publication of Annual and Quarterly Financial Statements and Other Disclosures by Licensed Banks".

2.2 Responsibility for Financial Statements

The Board of Directors of the Bank is responsible for the preparation and presentation of the Financial Statements of the Group and the Bank as per the provisions of the Companies Act No. 07 of 2007 and Sri Lanka Accounting Standards.

The Board of Directors acknowledges their responsibility for Financial Statements as set out in the "Annual Report of the Board of Directors", "Statement of Directors' Responsibility" and the certification on the Statement of Financial Position on pages 4, 108 and 159, respectively.

These Financial Statements include the following components:

- an Income Statement and a Statement of Profit or Loss and Other Comprehensive Income providing the information on the financial performance of the Group and the Bank for the year under review. Refer pages 157 and 158;
- a Statement of Financial Position (SOFP) providing the information on the financial position of the Group and the Bank as at the year end. Refer page 159;
- a Statement of Changes in Equity depicting all changes in shareholders' funds during the year under review of the Group and the Bank. Refer pages 160 to 167;
- a Statement of Cash Flows providing the information to the users, on the ability of the Group and the Bank to generate cash and cash equivalents and utilisation of those cash flows. Refer page 168;
- Notes to the Financial Statements comprising Significant Accounting Policies and other explanatory information. Refer pages 169 to 353.

2.3 Approval of Financial Statements by the Board of Directors

The Financial Statements of the Group and the Bank for the year ended December 31, 2018 (including comparatives for 2017), were approved and authorised for issue by the Board of Directors in accordance with Resolution of the Directors on February 22, 2019.

2.4 Basis of measurement

The Financial Statements of the Group have been prepared on the historical cost basis except for the following material items stated in the SOFP.

Table – 35

Items	Basis of measurement	Note No./s	Page/s
Financial instruments measured at fair value through profit or loss including derivative financial instruments (from January 1, 2018) Held-for-trading financial instruments including derivative financial instruments (Up to December 31, 2017)	Fair value	32, 33 & 46	233,234 & 278
Financial assets measured at fair value through other comprehensive income (from January 1, 2018) Financial investments – Available for sale (Up to December 31, 2017)	Fair value	37	250
Land and buildings	Measured at cost at the time of acquisition and subsequently at revalued amounts which are the fair values at the date of revaluation	40	258
Defined benefit obligation	Net liability for defined benefit obligations are recognised as the present value of the defined benefit obligation, less net total of the plan assets, plus unrecognised actuarial gains, less unrecognised past service cost, and unrecognised actuarial losses	50	282
Equity settled share-based payment arrangements	Fair Value on grant date	54	295

2.5 Going concern basis of accounting

The Management 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 of the Group continue to be prepared on a going concern basis.

2.6 Functional and presentation currency

Items included in these Financial Statements are measured using the currency of the primary economic environment in which the Bank operates (the Functional Currency).

Each entity in the Group determines its own functional currency and items included in the Financial Statements of these entities are measured using that Functional Currency. There was no change in the Group's Presentation and Functional Currency during the year under review.

These Financial Statements are presented in Sri Lankan Rupees, the Group's Functional and Presentation Currency.

The information presented in US Dollars in the Sections on "Annexes 9 and 10" on pages 426 and 427 does not form part of the Financial Statements and is made available solely for the information of stakeholders.

2.7 Presentation of Financial Statements

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

No adjustments have been made for inflationary factors affecting the Financial Statements.

An analysis on recovery or settlement within 12 months and after more than 12 months from the Reporting date is presented in Note 62 on pages 307 and 309.

2.8 Rounding

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

2.9 Offsetting

Financial assets and financial liabilities are offset and the net amount reported in the SOFP, 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.

2.10 Materiality and aggregation

Each material class of similar items is presented separately in the Financial Statements. Items of dissimilar nature or function are presented separately, unless they are immaterial as permitted by the LKAS 1 and amendments to the LKAS 1 on "Disclosure Initiative" which was effective from January 1, 2016.

Notes to the Financial Statements are presented in a systematic manner which ensures the understandability and comparability of Financial Statements of the Group and the Bank. Understandability of the Financial Statements is not compromised by obscuring material information with immaterial information or by aggregating material items that have different natures or functions.

2.11 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 presentation and classification of the Financial Statements of the previous year are amended, where relevant for better presentation and to be comparable with those of the current year. The Group/Bank has not restated the comparative information for 2017 for financial instruments within the scope of Sri Lanka Accounting Standard – SLFRS 9 on "Financial Instruments" (SLFRS 9). Therefore, the comparative information for 2017 is reported under Sri Lanka Accounting Standard – LKAS 39 on "Financial Instruments: Recognition and Measurement" (LKAS 39) and is not comparable to the information presented for 2018. Differences arising from adoption of SLFRS 9 have been recognised directly in equity as of January 1, 2018 and are disclosed in Note 12 on pages 196 to 201.

2.12 Use of significant accounting judgements and assumptions and estimates

In preparing the Financial Statements of the Group in conformity with SLFRSs and LKASs, the Management has made judgements, estimates and assumptions which 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 prospectively.

Significant areas of critical judgements, assumptions and estimation uncertainty, in applying Accounting Policies that have most significant effects on the amounts recognised in the Financial Statements of the Group are as follows:

A. Significant accounting judgements

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 Notes 2.12.1 and 2.12.2 below.

2.12.1 Determination of control over investees

Management applies its judgement to determine whether the control indicators set out in Note 38 on page 254 indicates that the Group controls the investees.

2.12.2 Classification of financial assets and liabilities

Applicable from January 1, 2018

As per SLFRS 9, the Significant Accounting Policies of the Group provides scope for financial assets to be classified and subsequently measured into different categories, namely, at Amortised Cost, Fair Value through Other Comprehensive Income (FVOCI) and Fair Value Through Profit or Loss (FVTPL) based on the following criteria;

- The entity's business model for managing the financial assets as set out in Note 7.1.3.1 on page 182.
- The contractual cash flow characteristics of the financial assets as set out in Note 7.1.3.2 on page 183.

Applicable up to December 31, 2017

The Significant Accounting Policies of the Group provided scope for assets to be classified at inception into different financial asset categories under certain circumstances as per LKAS 39.

- In classifying financial assets or liabilities at "Fair value through profit or loss" (FVTPL), the Group has determined that it has met the criteria for this designation set out in Notes 32, 33 and 46 on pages 233, 234 and 278.

- In classifying financial assets as "Held to maturity" (HTM), the Group has determined that it has both the positive intention and ability to hold the assets until their maturity date as required by Note 36 on page 247.
- In classifying financial assets as "Loans and Receivables" (L&R), the Group has determined that it has met the criteria for this designation set out in Notes 34, 35 and 36 on pages 238, 239 and 247.
- In classifying financial assets as "Available for sale" (AFS), the Group has determined that all non-derivative financial assets that are designated as AFS or those financial assets not classified as loans and receivables, FVTPL or HTM be classified as AFS as set out in Note 37 on page 250.

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 2.12.3 to 2.12.10 below.

2.12.3 Fair Value of financial instruments

The fair values of financial assets and financial liabilities recognised on the SOFP, for which there is no observable market price are determined using a variety of valuation techniques that include the use of mathematical models. The Group measures fair value using the fair value hierarchy that reflects the significance of inputs used in making measurements. Methodologies used for valuation of financial instruments and fair value hierarchy are stated in Note 28 on pages 225 to 230.

2.12.4 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 Life time 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 (PDs), Exposure At Default (EAD) and Loss Given Default (LGD);
- Selection of forward-looking macro-economic scenarios and their probability weightings, to derive the economic inputs into the ECL models.

As per LKAS 39, the collective provision for groups of homogeneous loans is established using statistical methods (such as, net flow rate methodology, risk migration analysis) or, a formula approach based on historical loss rate experience, using the statistical analysis of historical data on delinquency to estimate the amount of loss. Management applies judgement to ensure that the estimate of loss arrived at, on the basis of historical information is appropriately adjusted to reflect the economic conditions and portfolio factors as at the reporting date. The loss rates are regularly reviewed against actual loss experience.

In assessing the need for collective impairment, Management considers factors such as credit quality (for example, loan to collateral ratio, level of restructured performing loans), portfolio size, concentrations and economic factors. To estimate the required allowance, assumptions are made to define how inherent losses are modelled and to determine the required input parameters, based on historical experience and current economic conditions (including policy rates, inflation, growth in Gross Domestic Product, sovereign rating etc.).

The accuracy of the provision depends on the model assumptions and parameters used in determining the collective provision.

Refer Note 19 on page 208 for details.

2.12.4.1 Impairment losses on financial investments – available for sale (AFS) (up to December 31, 2017)

The Group reviewed the debt securities classified as AFS investments at each Reporting date to assess whether they are impaired. This required similar judgements as applied on the individual assessment of loans and advances.

The Group also recorded impairment charges on AFS equity investments when there had been a significant or prolonged decline in the fair value below their cost along with the historical share price movements, duration and extent up to which the fair value of an investment is less than its cost.

Refer Note 7.1.12.6.2 on page 189 for details.

2.12.5 Impairment of non-financial assets

The Group assesses whether there are any indicators of impairment for an asset or a Cash Generating Unit (CGU) at each reporting date or more frequently, if events or changes in circumstances necessitate to do so. This requires the estimation of the "Value in use" of such individual assets or the CGUs. Estimating "Value in use" requires the Management to make an estimate of the expected future cash flows from the asset or the CGU and also to select a suitable discount rate in order to calculate the present value of the relevant cash flows. This valuation requires the Group to make estimates about expected future cash flows and discount rates and hence, they are subject to uncertainty.

Refer Note 7.5 on page 190 for details.

2.12.6 Revaluation of property, plant and equipment

The Group measures land and buildings at revalued amounts with changes in fair value being recognised in Equity through Other Comprehensive Income (OCI). The Group engages independent professional valuers to assess fair value of land and buildings in terms of Sri Lanka Accounting Standard – SLFRS 13 on "Fair Value Measurement" (SLFRS 13). The key assumptions used to determine the fair value of the land and building and sensitivity analyses are provided in Note 40.5 (b) and 40.5 (c) on pages 265 to 269.

2.12.7 Useful life-time of the 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.

Refer Note 21 on page 213.

2.12.8 Deferred tax assets

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

Refer Note 43 on page 275 for details.

2.12.9 Defined benefit obligation

The costs of the defined benefit plans are determined using an actuarial valuation. The actuarial valuation involves making assumptions about discount rates, expected rates of return on assets, future salary increases, mortality rates, future pension increases etc. Due to the long-term nature of these plans, such estimates are subject to significant uncertainty.

Refer Note 50 on pages 282 to 290 for the assumptions used.

2.12.10 Provisions for liabilities, commitments and contingencies

The Group receives legal claims in the normal course of business. Management has made 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 depends on the due processes in respective legal jurisdictions.

Information about significant areas of estimation uncertainty and critical judgements in applying Accounting Policies other than those stated above that have significant effects on the amounts recognised in the Consolidated Financial Statements are described in Notes 7.9 to 7.14 on pages 192 and 193.

2.13 Events after the reporting period

Events after the reporting period are those events, favourable and unfavourable, that occur between the reporting date and the date when the Financial Statements are authorised for issue.

In this regard, all material and important events that occurred after the reporting period have been considered and appropriate disclosures are made in Note 70 on page 353, where necessary.

3. Financial Risk Management

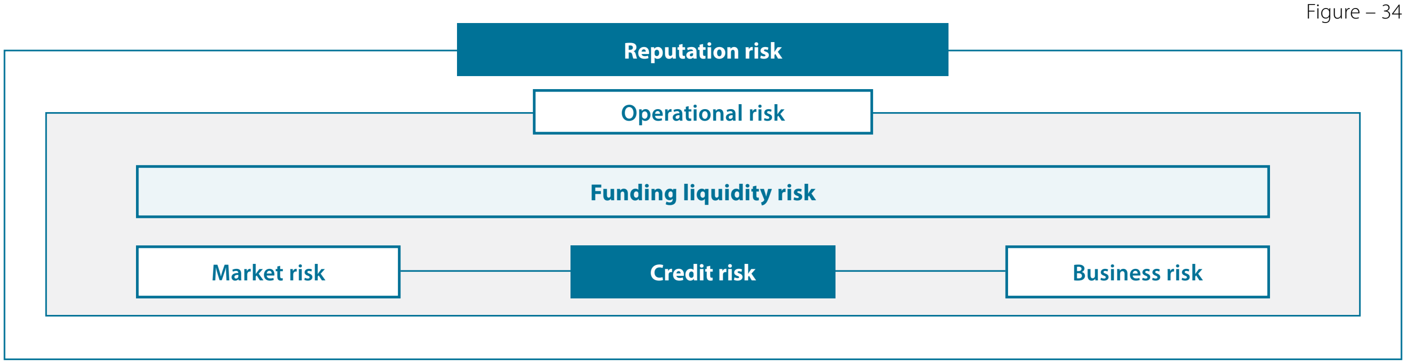
3.1 Introduction and overview

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

The Group has exposure mainly to the following risks from financial instruments:

- Credit risk;
- Market risk;
- Liquidity risk; and
- Operational risk.

Figure – 34



3.2 Bank's risk management framework

The Board of Directors of the Bank has the overall responsibility for the establishment and oversight of the Bank's Risk Management Framework.

The Risk Management Policy of the Bank translates overall risk appetite on business activities in a holistic approach to provide the guidance required for convergence of strategic and risk perspectives of the Bank.

The Group's risk management policies are established to identify and analyse the risks faced by the Group, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. The Risk Management Policy Framework constitutes the Credit Policy, Lending Guidelines, ALM Policy including Liquidity Risk Policy, Foreign Exchange Policy, Operational Risk Policy, IT Risk Policy, Market Risk Policy, Stress Testing Policy, etc., which have been firmly established to provide control and guidance for decision making throughout the Bank in an uniform manner.

The Committee structure embedded to the system acts as a fact finding and decision making authority through meaningful discussions of multiple points of view. The Risk Management Committees effectively deliberate on matters at hand to provide guidance to the business lines with a view to managing risk in accordance with the strategic goals and risk appetite of the Bank.

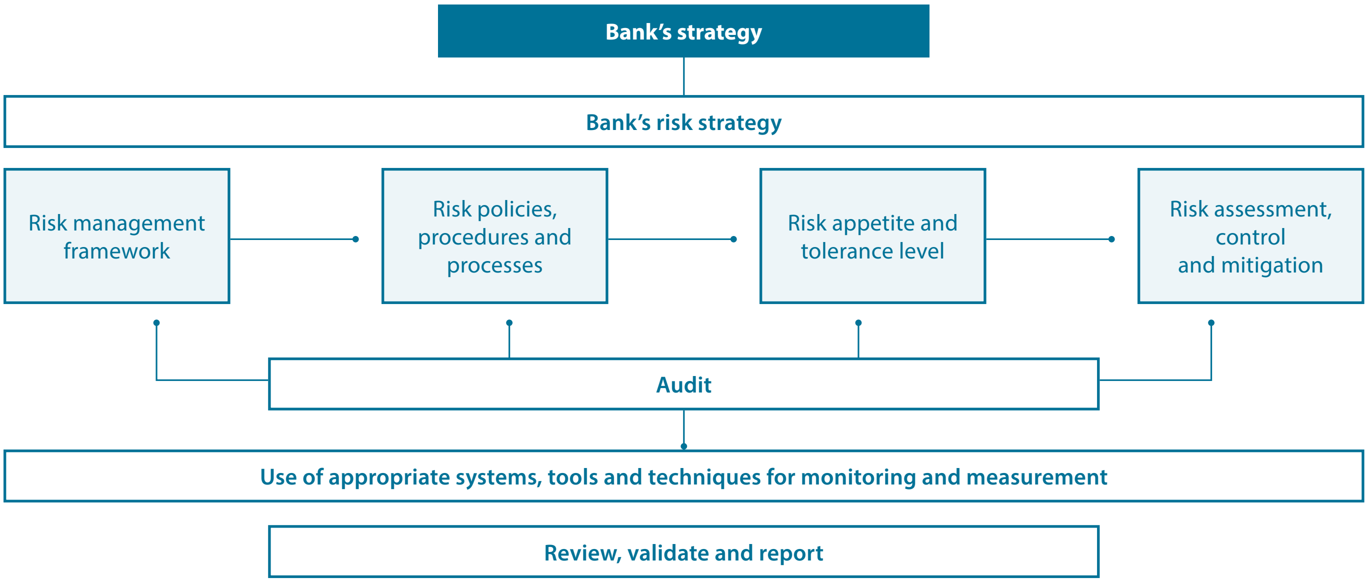
The Board of Directors of the Bank has formed a mandatory Board Committee namely, the Board Integrated Risk Management Committee (BIRMC) as per Banking Act Direction No. 11 of 2007 on Corporate Governance. The performance of the Committee and the duties and roles of members are reviewed by the Board annually.

The meetings of the Executive Integrated Risk Management Committee (EIRMC) are conducted on a monthly basis to discuss Credit, Operational and IT risk matters of the Bank while priority is given for liquidity and market risks at the Assets and Liabilities Committee (ALCO) meetings that convene at least once a fortnight.

Risk and Control Self-Assessment (RCSA) framework is adopted to identify risks involved in business activities of the Bank and to implement appropriate risk mitigatory measures after assessing criticality of such risks. The Integrated Risk Management Department carries out semi-annual Bank-wide RCSA function focusing on adherence to laws, regulations, and regulatory guidelines as well as internal controls and approved policies.

Further, the Internal Audit function of the Bank independently monitors and evaluates the risk management function of the Bank and provides their views on adequacy of the Risk Management Framework to the Board Audit Committee (BAC).

Bank's Financial Risk Management Framework Figure – 35



Credit risk

The risk that the Bank will incur a loss due to its customers or counterparties fail to discharge their contractual obligations.

The Bank manages and controls credit risk by setting limits on the amount of risk it is willing to accept for individual counterparties and for geographical and industry concentrations and by monitoring exposures in relation to such limits.

Management of credit risk

Lending Guidelines of the Bank formulated in consultation with lending units provide expected granularity of credit assessment, risk grading, their acceptability of collateral, etc., as well as limits on exposures and concentration levels to various sectors, counterparties, geographies, and segments.

A robust risk grading system incorporating Basel requirements of facility rating and counterparty rating are adopted by the Bank for evaluation of credit proposals. This risk grading framework consists 10 grades of varying degrees of risk as indicators for the Lending Officers to evaluate and arrive at suitable risk-reward trade-offs in their propositions. These risk grades are reviewed by the Integrated Risk Management Department regularly.

Portfolio level credit risk analyses are taken up at monthly EIRMC as well as quarterly BIRMC meetings. Individual credit proposals evaluated by the Lending Officers are approved by the Authorising Officers within the hierarchy in Delegated Authority Levels whilst ensuring a minimum of four eyes principle when approving any lending proposals. Escalation of approving levels occurs based on exposure levels as well as final risk ratings of borrowers.

The Executive Credit Committee (ECC) and the Board Credit Committee (BCC) are entrusted with approval of high value facilities while the Board will be the ultimate authority for approving facilities beyond predetermined threshold levels. Deliberations take place at BCC level on facilities taken up for approval within the specified threshold and recommendation for approval of the Board based on quantum of exposures proposed is exercised.

The Integrated Risk Management Department provides risk approval for individual proposals above predetermined threshold levels, consequent to a rigorous independent risk evaluation guided by Credit Policy, Lending Guidelines, and circular instructions within a limit framework stemming from risk appetite of the Bank.

Market risk

The risk that the fair value or future cash flows of financial instruments will fluctuate due to changes in market variables such as interest rates, foreign exchange rates and equity prices. The Bank classifies exposures to market risk into either trading or non-trading portfolios and manages each of those portfolios separately.

The market risk for the trading portfolio is monitored and managed closely.

Management of market risk

Market Risk Policy, ALM Policy and Foreign Exchange Risk Policy are the three main policies that constitute the framework governing the Market Risk Management function of the Bank.

Due to the business model adopted by the Bank, exposure to equity and commodity risk was kept at bay throughout the year.

However, Interest Rate Risk arising from the Banking Book as well as Trading Book and Foreign Exchange Risk arising from dealing in currencies other than local currency, continued to expose the Bank to associated risk elements.

Volatile interest scenarios experienced by the country during the period impacted the financial market in Sri Lanka and challenged the Net Interest Margin. Interest Rates of the Banking Book was subjected to varying degrees of rate shocks to identify impact on earnings perspective in such rate scenarios. The results reflected predictions which assisted the Bank in formulating strategies to manage the financial position in an effective manner with the limited choices available.

Trading Book too was subjected to Value at Risk (VaR) framework internally carried out by the Bank on a regular basis. The Bank also carried out sensitivity analysis on a regular basis to ascertain the impact on portfolios maintained, mainly in Government Securities and marking to market such portfolios to reflect fair value for decision making process.

Foreign exchange positions were maintained within the regulatory framework in a market where much volatility was observed in the major currency that the Bank deals in, i.e., US Dollars. The positions were subjected to sensitivity analysis to provide insight to possible losses/gains arising from currency appreciation/depreciation, as the reporting currency of the Bank being Sri Lankan Rupees.

Liquidity risk

The risk that the Bank will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset. Liquidity risk arises because of the possibility that the Bank might be unable to meet its payment obligations when they fall due under both normal and stress circumstances.

To limit this risk, Management has arranged diversified funding sources in addition to its core deposit base and adopted a policy of managing assets with liquidity in mind and monitoring future cash flows and liquidity on a daily basis. The Bank has developed internal control processes and contingency plans for managing liquidity risk. This incorporates an assessment of expected cash flows and the availability of high grade collateral which could be used to secure additional funding, if required.

Management of liquidity risk

Market Risk Management Policy and the ALM Policy of the Bank approved by the Board of Directors set the tone for managing liquidity risk of the Bank. Liquidity risk of the Bank is given utmost priority when managing a wide range of other risks due to the fact that it is considered as the most critical risk for any financial institution.

The Bank's Treasury Department is entrusted with managing liquidity of the Bank on real time basis to ensure smooth functioning of business activities of all other business units of the Bank.

Having access to a substantial stable Current Account and Savings Account (CASA) base due to its wide branch network and the top of the mind perception created in the depositors in general, for stability provides immense strength to the Bank in managing liquidity.

Having high quality liquid assets at the disposal of the Bank is another plus factor for the Bank. The strength of such was amply reflected in the Basel III computation the Bank carries out for arriving at Liquidity Coverage Ratio and Net Stable Funding Ratio as per the CBSL Directions that recorded very healthy results as compared to regulatory minimum threshold levels.

Contingency funding plans in force, constant monitoring of salient liquidity ratios and scenario based stress testing being carried out regularly, provide the sense of Bank with required indicators enabling the Bank to take proactive measures that could provide time to overcome any adverse liquidity position on a future date.

Operational risk

The risk that the Bank will incur a loss due to systems failure, human error, fraud or external events. When controls fail to operate effectively, operational risks can cause damage to reputation, have legal or regulatory implications or lead to financial loss. The Bank cannot expect to eliminate all operational risks, but it endeavours to manage these risks through a control framework and by monitoring and responding to potential risks.

Controls include effective segregation of duties, access, authorisation and reconciliation procedures, staff education and assessment processes, such as the use of internal audit.

Management of operational risk

Sound Operational Risk Management practices are embedded into the work process through the Bank's culture, internal policy framework and as per regulatory requirements.

Circular instructions and Operational Risk Management Policy play a major part in bringing together business practices with accepted benchmarks to ensure minimum disruption to processes, personnel, technology and infrastructure.

Internal control framework and audit function with firmly established "three lines of defences" serve the Bank to manage operational risk at current acceptable levels.

IT Risk of the Bank is managed through strict monitoring of Key IT Risk Indicators while Vulnerability Assessment and Penetration Tests are being carried out by both internal and external parties at regular intervals to identify the relevant risks.

Refer Note 69 on pages 319 to 353 for "Financial Risk Review".

A detailed write-up on how the risk management is carried out within the Bank's Risk Management Framework with due consideration given to factors such as governance, identification, assessment, monitoring, reporting and mitigation are discussed in the Section on "Risk Management" on pages 115 to 139. The said write-up does not form part of the Financial Statements.

4. 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.

When one is available, 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 of the factors that market participants would take into account 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, assuming that 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 takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use. External professional valuers are involved for valuation of significant assets such as land and building.

An analysis of fair value measurement of financial and non-financial assets and liabilities is provided in Note 28 on pages 225 to 230

5. Changes in Accounting Policies

The Group has consistently applied the Accounting Policies as set out in Notes 6 to 10 on pages 180 to 195 to all periods presented in these Financial Statements, except for the changes arising out of transition to SLFRS 9 and Sri Lanka Accounting Standard – SLFRS 7 (revised) on "Financial Instruments: Disclosures" (SLFRS 7) and Sri Lanka Accounting Standard – SLFRS 15 "Revenue from Contracts with Customers" (SLFRS 15) as set out below:

5.1 New and amended standards and interpretations

In these financial statements, the Group has applied SLFRS 9, SLFRS 7 and SLFRS 15, which are effective for the annual reporting periods beginning on or after January 1, 2018, for the first time. The Group has not early adopted any other standard, interpretation or amendment that has been issued but not effective.

5.1.1 SLFRS 9 – Financial Instruments

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

In accordance with the option given in SLFRS 9 not to restate the comparatives, the Group has not restated comparative information for 2017 for financial instruments within the scope of SLFRS 9. Therefore, comparative information for 2017 is reported under LKAS 39 and is not comparable with the information presented for 2018.

Differences arising from the adoption of SLFRS 9 have been recognised directly in equity as of January 1, 2018 and are disclosed in Note 12 on pages 196 to 201

5.1.1.1 Changes to classification and measurement

To determine their classification and measurement category, SLFRS 9 requires all financial assets, except equity instruments and derivatives, to be assessed based on a combination of the entity's business model for managing the assets and the instruments' cash flow characteristics.

Classification and measurement categories as specified in LKAS 39 for financial assets (FVTPL, HTM, L&R and AFS) have been replaced by;

- Financial assets measured at amortised cost
- Financial assets measured at Fair value through other comprehensive income (FVOCI)
- Financial assets measured at Fair value through profit or loss (FVTPL)

FVOCI includes debt and equity instruments measured at fair value through other comprehensive income. On derecognition of debt instruments measured at FVOCI, cumulative gains or losses are recycled to profit or loss. However, cumulative gains or losses on derecognition of equity instruments measured at FVOCI are not reclassified to profit or loss and transferred directly to retained earnings.

SLFRS 9 largely retains the existing requirements in LKAS 39 for the classification of financial liabilities. However, under LKAS 39, all fair value changes of liabilities designated under the fair value option were recognised in profit or loss. Under SLFRS 9 fair value changes are generally presented as follows:

- The amount of change in the fair value that is attributable to changes in the credit risk of the liability is presented in Other Comprehensive Income (OCI); and
- The remaining amount of change in the fair value is presented in profit or loss.

Note 7.1.4 on page 184 provides an explanation on how the Bank classifies financial liabilities under SLFRS 9.

Under SLFRS 9, derivatives embedded in a host financial asset are no longer treated as separate derivatives. Instead such financial instruments are classified based on the business model and their contractual terms, as explained in Notes 7.1.3.1 and 7.1.3.2 respectively on page 182 to 183. The accounting treatment for derivatives embedded in financial liabilities and non-financial host contracts has not changed. The Group's accounting policies for embedded derivatives are set out in Notes 32 and 46 on pages 233 and 278

The following assessments have been made on the basis of the facts and circumstances that existed at the transition date; i.e. January 1, 2018.

- The determination of the business model within which a financial asset is held.
- The designation and revocation of previous designations of certain financial assets and financial liabilities as measured at FVTPL.
- The designation of certain investments in equity instruments not held for trading as at FVOCI.
- For financial liabilities designated at FVTPL, the determination of whether presenting the effects of changes in the financial liability's credit risk in OCI would create or enlarge an accounting mismatch in profit or loss.

The Group's classification of its financial assets and liabilities is given in Notes 7.1.3 and 7.1.4 on pages 182 and 184 The quantitative impact of applying SLFRS 9 as at January 1, 2018 is disclosed in Note 12 on pages 196 to 201

5.1.1.2 Changes to the impairment calculation

The adoption of SLFRS 9 has fundamentally changed the Group's accounting for loan loss impairments by replacing the incurred loss approach under LKAS 39 with a forward-looking expected credit loss (ECL) approach. SLFRS 9 requires the Group to record an allowance for ECLs for all loans and other debt financial assets not held at FVTPL, together with loan commitments and financial guarantee contracts but not to equity investments. Under SLFRS 9, credit losses are recognised earlier than under LKAS 39.

The allowance is based on the ECLs associated with the PD in the next twelve months unless there has been a significant increase in credit risk since origination. Lifetime expected credit loss is provided for financial assets for which the credit risk has increased significantly from initial recognition and the credit impaired assets subsequent to initial recognition. If the financial asset meets the definition of purchased or originated credit impaired (POCI), the allowance is based on the change in the ECLs over the life of the asset.

If a debt security had low credit risk at the date of initial application of SLFRS 9, then the Group has assumed that credit risk on the asset had not increased significantly since its initial recognition.

Details of the Group's impairment method are disclosed in Note 19 on page 208

5.1.2 SLFRS 7 (Revised) – Financial Instruments: Disclosures

The Group adopted SLFRS 7 together with SLFRS 9, effective from January 1, 2018. Changes including transition disclosures as shown in Note 12 on pages 196 to 201 together with detailed qualitative and quantitative information about the ECL calculations such as the assumptions and inputs used are disclosed as per the requirements of the Standards in Note 19 on page 208.

Movements during the year in the ECL allowances are presented in Note 29.1 (page 231 Note 31.1 (page 233), Note 34.1 (page 238), Note 35.2 (page 242), Note 36.1 (page 248), Note 37.2 (page 251) and Note 59.4 (page 305).

5.1.3 SLFRS 15 – Revenue from contracts with customers

SLFRS 15 replaces revenue recognition guidance, including LKAS 18 on "Revenue", LKAS 11 on "Construction Contracts" and IFRIC 13 on "Customer Loyalty Programmes" and is effective for annual reporting periods beginning on or after January 1, 2018.

SLFRS 15 provides a comprehensive framework for determining whether, how much, and when revenue is recognised. SLFRS 15 requires new qualitative and quantitative disclosure aimed at enabling users of Financial Statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers.

Entities are required to apply five-step model to determine when to recognise revenue and at what amount. The model specifies that revenue is recognised when or as an entity transfers control of goods and services to a customer at the amount at which the entity expects to be entitled.

There is no significant impact on the Financial Statement of the Group and the Bank resulting from the application of SLFRS 15.

Significant accounting policies

The Significant Accounting Policies set out below have been applied consistently to all periods presented in the Financial Statements of the Group except as specified in Note 2.11 on page 172

These Accounting Policies have been applied consistently by Group entities.

Set out below is an index of Significant Accounting Policies, the details of which are available on the pages that follow:

Table – 36

6. Significant Accounting Policies – General

6.1 Basis of consolidation

The Group's Financial Statements comprise, Consolidated Financial Statements of the Bank and its Subsidiaries in terms of the Sri Lanka Accounting Standard – SLFRS 10 on "Consolidated Financial Statements" (SLFRS 10) and the proportionate share of the profit or loss and net assets of its Associates in terms of the Sri Lanka Accounting Standard – LKAS 28 on "Investments in Associates and Joint Ventures" (LKAS 28). The Bank's Financial Statements comprise the amalgamation of the Financial Statements of the Domestic Banking Unit, the Offshore Banking Centre and the international operations of the Bank.

6.1.1 Business combinations

Business combinations are accounted for using the acquisition method when control is transferred to the Group as per Sri Lanka Accounting Standard – SLFRS 3 on "Business Combinations" (SLFRS 3). The consideration transferred in the acquisition and identifiable net assets acquired are measured at fair value. Any goodwill that arises is tested annually for impairment (Refer Note 7.5 on page 190). Any gain on a bargain purchase is recognised in profit or loss immediately. Transaction costs are expensed as incurred, except if they are related to the issue of debt or equity securities.

The consideration transferred does not include amounts related to the settlement of pre-existing relationships. Such amounts are generally recognised in profit or loss.

Any contingent consideration is measured at fair value at the date of acquisition. If an obligation to pay contingent consideration that meets the definition of a financial instrument is classified as equity, then it is not remeasured and settlement is accounted for within equity. Otherwise, subsequent changes in the fair value of the contingent consideration are recognised in profit or loss.

6.1.2 Non-Controlling Interests (NCI)

Details of NCI are given in Note 58 on page 302.

6.1.3 Subsidiaries

Details of the Bank's subsidiaries, how they are accounted in the Financial Statements of the Bank and their contingencies are set out in Notes 38 and 59.5 (a) on pages 254 to 256 and 305 respectively.

6.1.4 Loss of control

When the Group loses control over a subsidiary, it derecognises the assets and liabilities of the subsidiary, and any related NCI and other components of equity. Any resulting gain or loss is recognised in profit or loss. Any interest retained in the former subsidiary is measured at fair value when control is lost.

Subsequently, it is accounted for as an Associate or in accordance with the Group's Accounting Policy for financial instruments depending on the level of influence retained.

6.1.5 Associates

Details of associates, how they are accounted in the Financial Statements of the investee together with their fair values and the Group's share of contingent liabilities of such associates are set out in Notes 39 and 59.5(b) on pages 256 to 258 and 305 respectively.

6.1.6 Transactions eliminated on consolidation

Intra-group balances, transactions and any unrealised income and expenses (except for foreign currency transaction gains or losses) arising from intra-group transactions are eliminated in preparing the Consolidated Financial Statements. Unrealised gains arising from transactions with equity accounted investees are eliminated against the investment to the extent of the Group's interest in the investee. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

6.1.7 Material gains or losses, provisional values or error corrections

There were no material gains or losses, provisional values or error corrections recognised during the year in respect of business combinations that took place in previous periods.

6.2 Foreign currency

6.2.1 Foreign currency transactions and balances

Foreign currency transactions are translated into the functional currency, which is Sri Lankan Rupees, using the exchange rates prevailing at the dates of the transactions. In this regard, the Bank's practice is to use the middle rate of exchange ruling at the date of the transaction.

Monetary assets and liabilities denominated in foreign currencies as at the reporting date are translated into the functional currency at the middle exchange rate of the functional currency ruling as at the reporting date. The foreign currency gain or loss on monetary items is the difference between amortised cost in the functional currency as at the beginning of the year adjusted for effective interest and payments during the year and the amortised cost in foreign currency translated at the exchange rate as at the reporting date.

Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are translated into the functional currency at the spot exchange rate at the date that the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate as at the date of the transaction.

Foreign currency differences arising on translation are generally recognised in profit or loss. However, foreign currency differences arising from the translation of the following items are recognised in OCI:

- Equity instruments measured at fair value through other comprehensive income (from January 1, 2018)
- Available-for-sale equity instruments (Up to December 31, 2017);
- A financial liability designated as a hedge of the net investment in a foreign operation to the extent that the hedge is effective; and
- Qualifying cash flow hedges to the extent that the hedge is effective.

6.2.2 Foreign currency translations

The Group's Consolidated Financial Statements are presented in Sri Lankan Rupees, which is also the Bank's Functional Currency. The Financial Statements of the Offshore Banking Centre of the Bank and the Financial Statements of the foreign operations of the Bank have been translated into the Group's Presentation Currency as explained under Notes 6.2.3 and 6.2.4 below.

6.2.3 Transactions of the offshore banking centre

These are recorded in accordance with Note 6.2.1 above, except the application of the annual weighted average exchange rate for translation of the Income Statement and the Statement of Profit or Loss and Other Comprehensive Income. Net gains and losses are dealt through the profit or loss.

6.2.4 Foreign operations

The results and financial position of overseas operations that have a functional currency different from the Bank's presentation currency are translated into the Bank's presentation currency as follows:

- Assets and liabilities, including goodwill and fair value adjustments arising on acquisition, are translated at the rates of exchange ruling as at the reporting date.
- Income and expenses are translated at the average exchange rate for the period, unless this average rate is not a reasonable approximation of the rate prevailing at the transaction date, in which case income and expenses are translated at the exchange rates ruling at the transaction date.
- All resulting exchange differences are recognised in the OCI and accumulated in the Foreign Currency Translation Reserve (Translation Reserve), which is a separate component of Equity, except to the extent that the translation difference is allocated to the NCI.

When a foreign operation is disposed of such that the control is lost, the cumulative amount in the translation reserve related to that foreign operation is reclassified to profit or loss as part of the gain or loss on disposal. If the Group disposes of only part of its interest in a subsidiary that includes a foreign operation while retaining control, then the relevant proportion of the cumulative amount of the translation reserve is reattributed to NCI.

7. Significant Accounting Policies – Recognition of Assets and Liabilities

7.1 Financial instruments – initial recognition, classification and subsequent measurement

7.1.1 Date of recognition

The Group initially recognises loans and advances, deposits and subordinated liabilities, etc., on the date on which they are originated. 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.

7.1.2 Initial measurement of financial instruments

The classification of financial instruments at initial recognition depends on their cash flow characteristics and the business model for managing the instruments. Refer Notes 7.1.3 and 7.1.4 for further details on classification of financial instruments.

A financial asset or financial liability is measured initially at fair value plus or minus transaction costs that are directly attributable to its acquisition or issue, except in the case of financial assets and financial liabilities at fair value through profit or loss as per SLFRS 9 and trade receivables that do not have a significant financing component as defined by SLFRS 15.

Transaction cost in relation to financial assets and financial liabilities at fair value through profit or loss are dealt with through the Income Statement.

Trade receivables that do not have significant financing component are measured at their transaction price at initial recognition as defined in SLFRS 15.

When the fair value of financial instruments (except trade receivables that do not have significant financing component) at initial recognition differs from the transaction price, the Group accounts for the Day 1 profit or loss, as described below.

7.1.2.1 "Day 1" profit or loss

When the transaction price of the instrument differs from the fair value at origination and fair value is based on a valuation technique using only inputs observable in market transactions, the Group recognises the difference between the transaction price and fair value in net gains/(losses) from trading. In those cases, where the fair value is based on models for which some inputs are not observable, the difference between the transaction price and the fair value is deferred and is only recognised in profit or loss 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.

Refer Notes 14 and 20 on pages 202 and 213

7.1.3 Classification and subsequent measurement of financial assets

From January 1, 2018 as per SLFRS 9, the Group classifies all of its financial assets based on the business model for managing the assets and the assets' contractual terms measured at either;

- Amortised cost
- Fair value through other comprehensive income (FVOCI)
- Fair value through profit or loss (FVTPL)

The subsequent measurement of financial assets depends on their classification.

Up to December 31, 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 (FVTPL), 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 12 on pages 196 to 201.

7.1.3.1 Business model assessment

With effect from January 1, 2018, the Group makes an assessment of the objective of a business model in which an asset is held at a portfolio level and not assessed on instrument-by- instrument basis because this best reflects the way the business is managed and information is provided to management. The information considered includes:

- the stated policies and objectives for the portfolio and the operation of those policies in practice. In particular, whether management's strategy focuses on earning contractual interest revenue, maintaining a particular interest rate profile, matching the duration of the financial assets to the duration of the liabilities that are funding those assets or realising cash flows through the sale of the assets;
- how the performance of the portfolio is evaluated and reported to the Bank's management;
- the risks that affect the performance of the business model (and the financial assets held within that business model) and how those risks are managed;
- how managers of the business are compensated – e.g. whether compensation is based on the fair value of the assets managed or the contractual cash flows collected; and
- the frequency, volume and timing of sales in prior periods, the reasons for such sales and its expectations about future sales activity. However, information about sales activity is not considered in isolation, but as part of an overall assessment of how the Bank's stated objective for managing the financial assets is achieved and how cash flows are realised.

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.

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

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

For the purposes of this assessment, "principal" is defined as the fair value of the financial asset on 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).

"Interest" is defined as consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs, as well as profit margin.

In contrast, contractual terms that introduce a more than de minimise 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 principal amount outstanding. In such cases, the financial asset is required to be measured at FVTPL.

In assessing whether the contractual cash flows are solely payments of principal and interest on principal amount outstanding, the Group considers the contractual terms of the instrument. This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition. In making the assessment, the Group considers:

- contingent events that would change the amount and timing of cash flows;
- leverage features;
- prepayment and extension terms;
- terms that limit the Group's claim to cash flows from specified assets; and
- features that modify consideration of the time value of money.

The Group holds a portfolio of long-term fixed rate loans for which the Group has the option to propose to revise the interest rate at periodic reset dates. These reset rights are limited to the market rate at the time of revision. The borrowers have an option to either accept the revised rate or redeem the loan at par without penalty. The Group has determined that the contractual cash flows of these loans are solely payments of principal and interest because the option varies the interest rate in a way that is consideration for the time value of money, credit risk, other basic lending risks and costs associated with the principal amount outstanding.

Refer Notes 7.1.3.3 to 7.1.3.8 below for details on different types of financial assets recognised on the SOFP.

7.1.3.3 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 FVTPL:

- 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 in Notes 7.1.3.3.1 to 7.1.3.3.6 below.

7.1.3.3.1 Loans and advances to banks and other customers

Loans and advances to banks and other customers include amounts due from banks, loans and advances and lease receivables of the Group.

Details of "Loans and advances to banks and other customers" are given in Notes 34 and Note 35 on pages 238 to 247.

7.1.3.3.2 Securities purchased under resale agreements (reverse repos)

When the Group purchases a financial asset and simultaneously enters into an agreement to resale the asset (or a similar asset) at a fixed price on a future date (reverse repo), the arrangement is accounted for as a financial asset in the SOFP reflecting the transaction's economic substance as a loan granted by the Group. Subsequent to initial recognition, these securities issued are measured at amortised cost using the EIR with the corresponding interest income/receivable being recognised as interest income in profit or loss.

Details of "Securities purchased under resale agreements" are given in the SOFP on page 159.

7.1.3.3.3 Debt and other financial instruments measured at amortised cost

Details of "Debt and other financial instruments measured at amortised cost" are given in Note 36 on page 247.

7.1.3.3.4 Cash and cash equivalents

Details of "Cash and cash equivalents" are given in Note 29 on page 231.

7.1.3.3.5 Balances with central banks

Details of "Balances with central banks" are given in Note 30 on page 232.

7.1.3.3.6 Placement with banks

Details of "Placement with banks" are given in Note 31 on page 233.

7.1.3.4 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 7.1.3.4.1 and 7.1.3.4.2.

7.1.3.4.1 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 37 on page 250.

7.1.3.4.2 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 37 on pages 250.

7.1.3.5 Financial assets measured at FVTPL
As per SLFRS 9, all financial assets other than those classified at amortised cost or FVOCI are classified as measured at FVTPL. 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 Notes 7.1.3.5.1 and 7.1.3.5.2 below.

As per LKAS 39, financial assets at fair value through profit or loss include financial assets held for trading and financial assets designated upon initial recognition at fair value through profit or loss.

7.1.3.5.1 Financial assets Held for trading
Details of "Financial Assets Held for trading" are given in Note 33 on pages 234.

7.1.3.5.1.1 Derivatives recorded at fair value through profit or loss
Details of "Derivative financial assets" recorded at fair value through profit or loss are given in Note 32 on pages 233.

7.1.3.5.2 Financial assets designated at fair value through profit or loss
As per SLFRS 9, on initial recognition, the Group may irrevocably designate a financial asset that otherwise meets the requirements to be measured at amortised cost or at FVOCI as at FVTPL when such designation eliminates or significantly reduces an accounting mismatch that would otherwise arise from measuring the assets or liabilities or recognising gains or losses on them on a different basis.

As per LKAS 39, the Group designated financial assets at fair value through profit or loss in the following circumstances:

- the assets are managed, evaluated and reported internally on a fair value basis; or
- the designation eliminates or significantly reduces an accounting mismatch, which would otherwise have arisen; or
- the asset contains an embedded derivative that significantly modifies the cash flows which would otherwise have been required under the contract.

Financial assets designated at fair value through profit or loss are recorded in the 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 has not designated any financial assets upon initial recognition as at fair value through profit or loss as at the end of the reporting period.

7.1.3.6 Financial investments – Held-to-maturity (Up to December 31, 2017)
Details of "Financial investments – Held to maturity" are given in Note 36 on page 247.

7.1.3.7 Financial investments – Loans and receivables (Up to December 31, 2017)
Details of "Financial investments – Loans and receivables" are given in Note 36 on page 247.

7.1.3.8 Financial investments – Available for sale (Up to December 31, 2017)
Details of "Financial investments – Available for sale" are given in Note 37 on page 250.

7.1.4 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.

Refer Notes 7.1.4.1 and 7.1.4.2 as detailed below:

7.1.4.1 Financial liabilities at fair value through profit or loss
Financial liabilities at fair value through profit or loss include financial liabilities held for trading and financial liabilities designated upon initial recognition as at fair value through profit or loss. Refer Notes 7.1.4.1.1 and 7.1.4.1.2 below.

7.1.4.1.1 Financial liabilities held for trading
Details of "Derivative financial liabilities" classified under Financial Liabilities Held for Trading are given in Note 46.1 on page 279.

7.1.4.1.2 Financial liabilities designated at fair value through profit or loss
Financial liabilities designated at fair value through profit or loss are recorded in the SOFP at fair value when

- The designation eliminates, or significantly reduces, the inconsistent treatment that would otherwise arise from measuring the assets or liabilities or recognising gains or losses on them on a different basis, or
- A group of financial liabilities or financial assets and financial liabilities is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided on that basis to entity's key management personnel, or
- The liabilities containing one or more embedded derivatives, unless they do not significantly modify the cash flows that would otherwise be required by the contract, or it is clear with little or no analysis when a similar instrument is first considered that separation of the embedded derivative(s) is prohibited.

Changes in fair value are recorded in "Net fair value gains/ (losses) from financial instruments at fair value through profit or loss" with the exception of movements in fair value of liabilities designated at FVTPL due to changes in the Bank's own credit risk. Such changes in fair value are recorded in the own credit reserve through OCI and do not get recycled to profit or loss. Interest paid/payable is accrued in "Interest expense", using the EIR.

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

7.1.4.2 Financial liabilities at amortised cost

Financial liabilities issued by the Group that are not designated at FVTPL are classified as financial liabilities at amortised cost under "Due to banks", "Due to depositors", "Securities sold under repurchase agreements", "Other borrowings" or "Subordinated liabilities" 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 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.

7.1.4.2.1 Due to banks

Details of "Due to banks" are given in Note 45 on page 278.

7.1.4.2.2 Due to depositors

Details of "Due to depositors" are given in Note 47 on page 280.

7.1.4.2.3 Securities sold under repurchase agreements (repos)

When the Group sells a financial asset and simultaneously enters into an agreement to repurchase the asset (or a similar asset) at a fixed price on a future date (repos), the arrangement is accounted for as a financial liability in the SOFP reflecting the transaction's economic substance as a deposit. Subsequent to initial recognition, these securities are measured at amortised cost using the EIR with the corresponding interest payable being recognised as interest expense in profit or loss.

Details of "Securities sold under repurchase agreements (repos)" are given in the SOFP on page 159.

7.1.4.2.4 Other Borrowings

Details of "Other Borrowings" are given in Note 48 on page 281.

7.1.4.2.5 Subordinated liabilities

Details of "Subordinated liabilities" are given in Note 52 on page 291.

7.1.5 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 SOFP.

The Group designates certain derivatives held for risk management as well as certain non-derivative financial instruments as hedging instruments in qualifying hedging relationships. On initial designation of the hedge, the Group formally documents the relationship between the hedging instrument and hedged item, including risk management objective and strategy in undertaking the hedge, together with the method that will be used to assess the effectiveness of the hedging relationship. The Group makes an assessment, both at inception of the hedge relationship and on an ongoing basis, of whether the hedging instrument is expected to be highly effective in offsetting the changes in fair value or cash flow of the respective hedged item during the period for which the hedge is designated, and whether the actual results of each hedge are within a range of 80% to 125%. The Group makes an assessment for a cash flow hedge of a forecast transaction, of whether the forecast transaction is highly probable to occur and presents an exposure to variations in cash flows that could ultimately affect profit or loss.

The Group currently uses cash flow hedging relationships for risk management purposes as discussed in the Notes 7.1.5.1 to 7.1.5.5 below:

7.1.5.1 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.

7.1.5.2 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.

Details of "Cash flow hedges" are given in Notes 32.2 and 46.2 on pages 234 and 279.

7.1.5.3 Net investment hedges

When a derivative instrument or a non-derivative financial liability is designated as the hedging instrument in a hedge of a net investment in a foreign operation, the effective portion of changes in the fair value of the hedging instrument is recognised in OCI and presented in the translation 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 on disposal of the foreign operation.

7.1.5.4 Other non-trading derivatives

If the derivative is not held for trading, and is not designated in a qualifying hedging relationship, then all changes in its fair value are recognised immediately in profit or loss as a component of net income from other financial instruments at fair value through profit or loss.

7.1.5.5 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 causes 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 FVTPL;
- 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.

Separated embedded derivatives are measured at fair value, with all changes in fair value recognised in profit or loss unless they form part of a qualifying cash flow or net investment hedging relationship. Separated embedded derivatives are presented in the SOFP together with the host contract. Derivatives embedded in financial assets are classified based on the business model and their contractual terms are not separated as explained in Note 7.1.3.1 and 7.1.3.2 on pages 182 and 183.

As per LKAS 39, the Group treated derivatives embedded in financial assets in addition to derivatives embedded in financial liabilities and non-financial host contracts as separate derivatives if they fulfilled the same criteria mentioned above.

Separated embedded derivatives are measured at fair value, with all changes in fair value recognised in profit or loss unless they formed part of a qualifying cash flow or net investment hedging relationship. Separated embedded derivatives are presented in the SOFP together with the host contract.

7.1.6 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.

7.1.6.1 Timing of reclassification of financial assets

Consequent to the change in the business model, the Bank reclassifies all affected assets prospectively from the first day of the first reporting period following the change in the business model (the reclassification date). Accordingly, prior periods are not restated.

7.1.6.2 Measurement of reclassification of financial assets

7.1.6.2.1 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.

7.1.6.2.2 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.

7.1.6.2.3 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.

7.1.7 Derecognition of financial assets and financial liabilities

7.1.7.1 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 any 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.

7.1.7.2 Financial liabilities

The Group derecognises a financial liability when its contractual obligations are discharged, cancelled or expired.

7.1.8 Modification of financial assets and financial liabilities

7.1.8.1 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.

As per LKAS 39, if the terms of a financial asset were modified because of financial difficulties of the borrower and the asset was not derecognised, then impairment of the asset was measured using pre-modification interest rate.

7.1.8.2 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.

7.1.9 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.

Income and expenses are presented on a net basis only when permitted under SLFRSs, or for gains and losses arising from a group of similar transactions such as in the Group's trading activity.

7.1.10 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.

7.1.11 Fair value of financial instruments

Fair value measurement of financial instruments including the fair value hierarchy is explained in Notes 4 and 28 on pages 178 and 225.

7.1.12 Identification and measurement of impairment of financial assets

7.1.12.1 Overview of the ECL principles

As per SLFRS 9, the Group records an allowance for expected credit losses for loans and advances to banks and other customers, debt and other financial instruments measured at amortised cost, debt instruments measured at fair value through other comprehensive income, loan commitments and financial guarantee contracts.

SLFRS 9 outlines a "three-stage" model for impairment based on changes in credit quality since initial recognition.

- Stage 1: A financial asset that is not originally credit-impaired on initial recognition is classified in Stage 1. Financial instruments in Stage 1 have their ECL measured at an amount equal to the proportion of lifetime expected credit losses (LTECL) that result from default events possible within next 12 months (12M ECL).
- Stage 2: If a significant increase in credit risk (SICR) since origination is identified, it is moved to Stage 2 and the Group records an allowance for LTECL. Refer Note 7.1.12.2 for a description on how the Group determines when a significant increase in credit risk has occurred.
- Stage 3: If a financial asset is credit-impaired, it is moved to Stage 3 and the Group recognises an allowance for LTECL, with probability of default at 100%. Refer Note 7.1.12.3 for a description on how the Group defines credit impaired and default.
- Purchased or originated credit impaired (POCI) financial assets: Financial assets which are credit impaired on initial recognition are categorised within Stage 3 with a carrying value already reflecting the lifetime expected credit losses. The Group does not have POCI loans as at the reporting date.

The key judgements and assumptions adopted by the Group in addressing the requirements of SLFRS 9 are discussed below:

7.1.12.2 Significant increase in credit risk

When determining whether the risk of default on a financial instrument has increased significantly since initial recognition, the Group considers reasonable and supportable information that is relevant and available without undue cost or effort. This includes both quantitative and qualitative information analysis, based on the Group's historical experience and expert credit assessment and including forward looking information.

The Group considers an exposure to have significantly increased credit risk when contractual payments of a customer are more than 30 days past due in accordance with the rebuttable presumption in SLFRS 9.

The Group individually reviews at each reporting date, loans and advances above a predefined threshold to identify whether the credit risk has increased significantly since origination, before an exposure is in default. Such indicators include, *inter alia*:

- 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 instruments.
- When the value of collateral is significantly reduced and/or realisibility 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
- 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
- Erosion in net-worth by more than 25% when compared to the previous year.

Credit facilities/exposures which have one or more of the above indicators are treated as facilities with significant increase in credit risk and assessed accordingly in ECL computations. The Group regularly monitors the effectiveness of the criteria used to identify significant increase in credit risk to confirm that the criteria is capable of identifying significant increase in credit risk before an exposure is in default.

For debt instruments having an external credit rating, which are measured at amortised cost or at FVOCI, the Group determines significant increase in credit risk based on the generally accepted investment/non-investment grade definitions published by international rating agencies. Debt instruments are moved to stage 2 if their credit risk increases to the extent that they are no longer considered investment grade.

7.1.12.3 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".

In assessing whether a borrower is in default, Group reviews its individually significant loans and advances above a predefined threshold at each reporting date. The Group considers non performing credit facilities/customers with one or more of indicators set out in Note 7.1.12.2 above as credit impaired. Further, as per "CBSL Guidelines to Licensed Banks on the Adoption of Sri Lanka Accounting Standard – SLFRS 9: Financial Instruments", all the credit facilities/ customers classified as non-performing as per CBSL Directions are assessed as Stage 3 exposure.

7.1.12.4 Movement between the stages

Financial assets can be transferred between the different categories (other than POCI) depending on their relative change in credit risk since initial recognition. Financial instruments are transferred out of stage 2 if their credit risk is no longer considered to be significantly increased since initial recognition based on the assessments described in Note 7.1.12.2. Financial instruments are transferred out of stage 3 when they no longer exhibit any evidence of credit impairment as described above.

7.1.12.5 Grouping financial assets measured on collective basis

The Group calculates ECLs either on a collective or an individual basis. Asset classes where the Group calculates ECL on individual basis include;

- Credit impaired facilities of individually significant customers
- The treasury, trading and interbank relationships (such as due from Banks, money at call and short notice, placements with Banks, government securities, investments in debentures etc.)

Those financial assets for which, the Group determines that no provision is required under individual impairment are then collectively assessed for ECL. For the purpose of ECL calculation on collective basis, financial assets are grouped on the basis of similar risk characteristics. Loans and advances to other customers are grouped into homogeneous portfolios, based on a combination of product and customer characteristics.

7.1.12.6 Identification and measurement of impairment of financial assets under LKAS 39

The Group assessed whether there is objective evidence that financial assets not carried at fair value through profit or loss are impaired as at the reporting date. A financial asset or a group of financial assets is "impaired" when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset(s) and that the loss event has an impact on the future cash flows of the asset(s) that can be estimated reliably.

Objective evidence that financial assets (including equity securities) were similar to the qualitative criteria given in Section 7.1.12.2 for identification of credit-impaired assets.

In addition, for an investment in an equity security, a significant or prolonged decline in its fair value below its cost was considered as an objective evidence of impairment.

7.1.12.6.1 Impairment of financial assets measured at amortised cost

Details of the individual and collective assessment of impairments are given in Note 19 on pages 208 to 212.

7.1.12.6.2 Impairment of financial investments – Available for sale

For available-for-sale financial investments, the Group assessed at each reporting date whether there was objective evidence that an investment was impaired.

In the case of debt instruments classified as AFS, the Group assessed individually whether there is objective evidence of impairment based on the same criteria as financial assets carried at amortised cost. However, the amount recorded for impairment was 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 profit or loss. Future interest income based on the reduced carrying amount/impaired balance was accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. The interest income on such assets was recorded within "Interest income".

In the case investments classified as AFS, objective evidence also included a "significant" or "prolonged" decline in the fair value of the investment below its cost. In general, the Group considered a decline of 20% to be "significant" and a period of nine months to be "prolonged". However, in specific circumstances a smaller decline or a shorter period was considered appropriate. Where there was evidence of impairment, the cumulative impairment loss on that investment previously recognised in Equity through the OCI was removed from Equity and charged to profit or loss.

If, in a subsequent period, the fair value of an impaired available-for-sale debt instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognised, then such impairment loss was reversed through profit or loss; otherwise, any increase in fair value was recognised through OCI. Any subsequent recovery in the fair value of an available-for-sale equity instrument was recognised in OCI.

The Group wrote off certain financial investments – available for sale, either partially or in full and any related provision for impairment losses, when the Group determines that there was no realistic prospect of recovery.

7.2 Non-current assets held for sale and disposal groups

The Group intends to recover the value of non-current assets and disposal groups classified as held for sale as at the reporting date principally through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the asset or disposal group is available for sale in its present condition, Management has committed to the sale and the sale is expected to have been completed within one year from the date of classification.

As per the Sri Lanka Accounting Standard – SLFRS 5 on "Non-current Assets Held for Sale and Discontinued Operations", these assets are measured at the lower of the carrying amount and fair value, less costs to sell. Thereafter, the Group assesses at each reporting date or more frequently if events or changes in circumstances indicate that the investment or a group of investment is impaired. The Group recognises an impairment loss for any initial or subsequent write down of the assets to fair value less costs to sell and also recognises a gain for any subsequent increase in fair value less costs to sell of an asset, only to the extent of the cumulative impairment losses that have been recognised previously. Impairment loss is first allocated to good will, and then to the remaining assets and liabilities on a *pro rata* basis, except that no loss is allocated to financial assets, deferred tax assets or employee benefit assets which continue to be measured in accordance with the Group's other accounting policies. As a result, once classified, the Group neither amortises nor depreciates the assets classified as held for sale.

In the Income Statement of the reporting period and of the comparable period of the previous year, income and expenses from discontinued operations are reported separately from income and expenses from continuing operations, down to the level of profit after taxes, even when the Group retains a NCI in a subsidiary after the sale. The resulting profit or loss (after taxes) is reported separately in the Income Statement.

7.3 Property, plant and equipment

Details of "Property, plant and equipment" are given in Note 40 on pages 258 to 271.

7.3.1 Depreciation

Details of "Depreciation" are given in Note 21 on pages 213 and 214.

7.3.2 Borrowing costs

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

7.4 Intangible assets

Details of "Intangible assets" are given in Note 41 on pages 271 to 273.

Amortisation recognised during the year in respect of intangible assets is included under the item of "Amortisation of intangible assets" under "Depreciation and amortisation" in profit or loss.

Refer Note 21 on pages 213 and 214

7.5 Impairment of non-financial assets

At each reporting date, the Group reviews the carrying amounts of its non-financial assets (other than investment properties and deferred tax assets) to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. Good will is tested annually for impairment.

For impairment testing, assets are grouped together into the smallest group of assets that generates cash inflows from continuing use that is largely independent of the cash inflows of other assets or CGUs. Goodwill arising from a business combination is allocated to CGUs or groups of CGUs that are expected to benefit from the synergies of the combination.

The "recoverable amount" of an asset or CGU is the greater of its value in use and its fair value less costs to sell. "Value in use" is based on the estimated future cash flows, discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or CGU.

An impairment loss is recognised if the carrying amount of an asset or CGU exceeds its recoverable amount.

The Group's corporate assets do not generate separate cash inflows and are used by more than one CGU. Corporate assets are allocated to CGUs on a reasonable and consistent basis and tested for impairment as part of the testing of the CGUs to which the corporate assets are allocated.

Impairment losses are recognised in profit or loss. They are allocated first to reduce the carrying amount of any goodwill allocated to the CGU, and then to reduce the carrying amounts of the other assets in the CGU on a *pro rata* basis.

An impairment loss in respect of goodwill is not reversed. For other assets, an impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

7.6 Dividends payable

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

Dividends for the year, that are approved after the reporting date and not provided for, are disclosed as an event after the reporting period in accordance with the Sri Lanka Accounting Standard – LKAS 10 on "Events after the Reporting Period" in Note 70 on page 353.

7.7 Employee benefits

7.7.1 Defined Benefit Plans (DBPs)

A defined benefit plan is a post-employment benefit plan other than a Defined contribution plan as defined in the Sri Lanka Accounting Standard – LKAS 19 on “Employee Benefits”.

7.7.1.1 Defined benefit pension plans

7.7.1.1.1 Description of the plans and employee groups covered

The Bank operates three types of Defined Benefit Pension Plans for its employees as described below:

(a) The Bank has an approved Pension Fund, which was established in 1992. As per the Deed of Trust, only those employees who were less than 45 years of age as at January 1, 1992 were covered by the Pension Fund in order to leave a minimum contribution for a period of 10 years before they are eligible to draw pension from the Pension Fund. Further, only the employees who joined the Bank on or before December 31, 2001, were in pensionable service of the Bank:

During 2006, the Bank offered a restructured pension scheme to convert the DBP to a Defined Contribution Plan (DCP) for the pensionable employees of the Bank and over 99% of them accepted it. As a result, the above Pension Fund now covers only those employees who did not opt for the restructured pension scheme and those employees who were covered by the Pension Fund previously but retired before the restructured pension scheme came into effect:

(b) Provision for pensions has been made for those employees who retired on or before December 31, 2001, and on whose behalf the Bank could not make contributions to the Retirement Pension Fund for more than 10 years. This liability although not funded has been provided for in full in the Financial Statements:

(c) Provision has been made in the Financial Statements for Retirement Gratuity from the first year of service for all employees who joined the Bank on or after January 1, 2002, as they are not in pensionable service of the Bank under either the DBP or DCP. However, if any of these employees resign before retirement, the Bank is liable to pay gratuity to such employees. This liability although not funded has been provided for in full in the Financial Statements.

The subsidiaries of the Bank do not operate Pension Funds.

The Bank’s net obligation in respect of Defined Benefit Pension Plans is calculated separately for each plan by estimating the amount of future benefit that employees have earned in the current and prior periods, discounting that amount and deducting the fair value of any plan assets, as per the Sri Lanka Accounting Standard – LKAS 19 on “Employee Benefits” as detailed in Note 50 on pages 282 to 290.

The past service cost is recognised as an expense on a straight-line basis over the period until the benefits become vested. If the benefits are already vested following the introduction of, or changes to, a pension plan, past service cost is recognised immediately.

7.7.1.1.2 Recognition of actuarial gains or losses

Actuarial gains or losses are recognised in the OCI in the period in which they arise.

7.7.1.1.3 Recognition of retirement benefit obligation

The defined benefit asset or liability comprises the present value of the defined benefit obligation, less past service cost not yet recognised and less the fair value of plan assets out of which the obligations are to be settled directly. The value of any asset is restricted to the sum of any 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 calculation of defined benefit obligations is performed annually by a qualified actuary using the Projected Unit Credit Method. When the calculation results in a potential asset for the Group, the recognised asset is limited to the present value of economic benefits available in the form of any future refunds from the plan or reductions in future contributions to the plan. To calculate the present value of economic benefits, consideration is given to any applicable minimum funding requirements.

Remeasurement of the net defined benefit liability, which comprises actuarial gains and losses, the return on plan assets (excluding interest) and the effect of the asset ceiling (if any, excluding interest), are recognised immediately in OCI. The Group determines the net interest expense/(income) on the net defined benefit liability/(asset) for the period by applying the discount rate used to measure the defined benefit obligation at the beginning of the annual period to the then net-defined benefit liability/(asset), taking into account any changes in the net-defined benefit liability/(asset) during the period as a result of contributions and benefit payments. Net interest expense and other expenses related to defined benefit plans are recognised in profit or loss.

When the benefits of a plan are changed or when a plan is curtailed, the resulting change in benefit that relates to past service or the gain or loss on curtailment is recognised immediately in profit or loss. The Group recognises gains and losses on the settlement of a defined benefit plan when the settlement occurs.

Amounts recognised in profit or loss as expenses on DBPs and provisions made on DBPs together with the details of valuation methods are given in Notes 20 and 50 on pages 213 and 282 respectively.

7.7.2 Defined Contribution Plans (DCPs)

A defined contribution plan is a post-employment plan under which an entity pays fixed contributions into a separate entity and will have no legal or constructive obligations to pay a further amount. Obligations to DCPs are recognised in the profit or loss as the related service is provided. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in future payments is available. The Group has three such plans as explained in Notes 7.7.2.1, 7.7.2.2 and 7.7.2.3 below.

Amounts recognised in profit or loss as expenses on DCPs are given in Note 20 on page 213.

7.7.2.1 Defined contribution pension plan

As explained in Note 7.7.1.1.1 (a), during 2006, the Bank restructured its pension scheme which was a DBP to a DCP. This restructured plan was offered on a voluntary basis to the eligible employees of the Bank. The scheme provides for lump sum payments instead of commuted/monthly pensions to the eligible employees at the point of their separation, in return for surrendering their pension rights.

The lump sum offered consisted of a past service package and a future service package. The shortfall on account of the past service package in excess of the funds available in the Pension Fund was borne by the Bank in 2006.

The future service package includes monthly contributions to be made by the Bank for the employees who accepted the offer, to be made during their remaining period of service, at predetermined contribution rates to be applied on their salaries, which are estimated to increase for this purpose at 10% p.a. based on the salary levels that prevailed as at the date of implementation of this scheme. In addition, interest to be earned on the assets of the DCP is also allocated to the employees who opted for the restructured scheme.

The assets of this Fund are held separately from those of the Bank and are independently administered by the Trustees as per the provisions of the Trust Deed.

7.7.2.2 Employees' Provident Fund

The Bank and employees contribute to an approved Private Provident Fund at 12% and 8% respectively, on the salaries of each employee. Other local entities of the Group and their employees contribute at the same percentages as above to the Employees' Provident Fund managed by the CBSL.

7.7.2.3 Employees' Trust Fund

The Bank and other local entities of the Group contribute at the rate of 3% of the salaries of each employee to the Employees' Trust Fund managed by the CBSL.

7.7.3 Other long-term employee benefits

The Group's net obligation in respect of long-term employee benefits other than pension plans is the amount of future benefits that employees have earned in return for their service in the current and prior periods. That benefit is discounted to determine its present value and the fair value of any related assets is deducted. The discount rate used as the yield as at the reporting date is the current market rate that has been extrapolated to reflect long-term rate of discount based on market rates of interest on short-term Corporate/Government Bonds and anticipated long-term rate of inflation. The calculation is performed using the Projected Unit Credit Method. Remeasurements are recognised in profit or loss in the period in which they arise.

The Group does not have any other long-term employee benefit plans.

7.7.4 Terminal benefits

Termination benefits are expensed at the earlier of when the Group can no longer withdraw the offer of those benefits and when the Group recognises costs for a restructuring. If benefits are not expected to be wholly settled within 12 months of the reporting date, then they are discounted.

7.7.5 Short-term employee benefits

Short-term employee benefits are expensed as the related service is provided. A liability is recognised for the amount expected to be paid if the Group has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be estimated reliably.

7.7.6 Share-based payment arrangements

Share-based payment arrangements in which the Group receives services as consideration for its own equity instruments are accounted for as equity-settled share-based payment transactions, regardless of how the equity instruments are obtained by the Group. Senior Executive Employees of the Group receive remuneration in the form of share-based payment transactions, where by employees render services as consideration for equity instruments (equity-settled transactions). The Group does not operate any cash-settled share-based payment transactions.

The Group applies the requirements of the Sri Lanka Accounting Standard – SLFRS 2 on "Share-based Payment" (SLFRS 2) in accounting for equity-settled share-based payment transactions, if any, that were granted after January 1, 2012 and had not vested at the same date. As per SLFRS 2, on the grant date fair value of equity-settled share-based payment awards (i.e., share options) granted to employees is recognised as personnel expense, with a corresponding increase in equity, over the period in which the employees unconditionally become entitled to the awards. The amount recognised as an expense is adjusted to reflect the number of share awards for which the related service and non-market performance vesting conditions are expected to be met, so that the amount ultimately recognised as an expense is based on the number of share awards that do meet the related service and non-market performance conditions at the vesting date. For share-based payment awards with non-vesting conditions, the grant date fair value of the share-based payment is measured to reflect such conditions and there is no true-up for differences between expected and actual outcomes.

The Employee Share Option Plan – 2015, which was granted is subjected to the above accounting treatment.

However, the Employee Share Option Plan – 2008 which was granted prior to January 1, 2012, the effective date of the SLFRS 2 was not subjected to the above accounting treatment and the proceeds received during the year by the Group in consideration for shares issued were accounted for as Stated Capital within Equity.

The details of Employee Share Option Plans are given in Notes 53.2 and 54 on pages 294 to 297.

The dilutive effect of outstanding options is reflected as additional share dilution in the computation of diluted Earnings per Share as disclosed in Notes 25.2 and 25.3 on page 219.

7.8 Other liabilities

Details of "Other liabilities" are given in Note 50 on pages 282 to 290.

7.9 Restructuring

Provision for restructuring is recognised when the Group has approved a detailed and formal restructuring plan, and the restructuring either has commenced or has been announced publicly. Future operating losses arising on such restructuring are not provided for.

The Group does not have any provision for restructuring as at the reporting date.

7.10 Onerous contracts

A provision for onerous contracts is recognised when the expected benefits to be derived by the Group from a contract are lower than the unavoidable cost of meeting its obligations under the contract. The provision is measured at the present value of the lower of the expected cost of terminating the contract and the expected net cost of continuing with the contract. Before a provision is established, the Group recognises any impairment loss on the assets associated with that contract.

The Group does not have any onerous contracts as at the reporting date.

7.11 Bank levies

A provision for Bank levies is recognised when the condition that triggers the payment of the levy is met. If a levy obligation is subject to a minimum activity threshold so that the obligating event is reaching a minimum activity, then a provision is recognised when that minimum activity threshold is reached.

7.12 Financial guarantees, letters of credit and undrawn loan commitments

"Financial 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.

Financial guarantees are initially recognised in the financial statements (within other liabilities) at fair value, being the premium received. Subsequent to initial recognition, the Bank's liability under each guarantee is measured at the higher of the amount initially recognised less cumulative amortisation recognised in the Income Statement, and – under LKAS 39 – the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee, or – under SLFRS 9 – an ECL provision if appropriate.

The premium received is recognised in profit or loss in "Net fees and commission income" on a straight-line basis over the life of the guarantee.

Similar to financial guarantee contracts for letters of credit and undrawn loan commitments, a provision was made if they were an onerous contract under LKAS 39, but from January 1, 2018, these contracts are in the scope of the ECL requirements. The nominal contractual value of financial guarantees, letters of credit and undrawn loan commitments, where the loan agreed to be provided is on market terms, are not recorded on in the SOFP. The nominal values of these instruments together with the corresponding ECLs are disclosed in Note 59 on page 303.

Loan commitments at below market interest rates drawdown are initially measured at fair value and subsequently measured at the higher of the amount of the ECL allowance and the amount initially recognised less, when appropriate, the cumulative amount of income recognised.

7.13 Commitments

All discernible risks are accounted for in determining the amount of known liabilities as explained in Note 7.8 above.

Details of the Commitments are given in Notes 59.2 and 59.3 on page 304.

7.14 Contingent liabilities and commitments

A detailed list of "Contingent liabilities and commitments" and "Litigation against the Bank and the Group" are given in Notes 59 and 61 on pages 303 and 306 respectively.

7.15 Stated capital and reserves

Details of the "Stated capital and reserves" are given in Notes 53, 55, 56 and 57 to the Financial Statements on pages 293, 297, 298 and 299 respectively.

7.16 Earnings per share (EPS)

Details of "Basic and Diluted EPS" are given in Note 25 on pages 218 and 219.

7.17 Operating segments

Details of "Operating segments" are given in Note 63 on pages 309 to 311.

7.18 Fiduciary assets

The Bank provides trust and other fiduciary services that result in the holding or investing of assets on behalf of its clients. Assets held in a fiduciary capacity are not reported in these Financial Statements as they do not belong to the Bank.

8. Significant accounting policies – Recognition of income and expense

Details of "Income and expense" are given in Notes 13 to 22 on pages 202 to 215.

8.1 Interest income and expense

Details of "Interest income and expense" are given in Note 14 on pages 202 to 205.

8.2 Fee and commission income and expense

Details of "Fees and commission income and expense" are given in Note 15 on pages 205 to 206.

8.3 Net gains/(losses) from trading

Details of "Net gains/(losses) from trading" are given in Note 16 on page 207.

8.4 Net gains/(losses) from derecognition of financial assets

Details of "Net gains/(losses) from derecognition of financial assets" are given in Note 17 on page 207.

8.5 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.

Dividends are presented in net gains/(losses) from trading, net gains/(losses) from financial investments or other income (net) based on the underlying classification of the equity investment.

Details of "Dividend income" are given in Notes 16 and 18 on pages 207 and 208.

8.6 Leases

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

8.6.1 Finance leases

8.6.1.1 Finance leases – Group as a lessee

Finance leases that transfer substantially all risks and rewards incidental to ownership of the leased item to the Group are classified as finance leases and capitalised at the commencement of the lease at the lower of the fair value of the leased property and the present value of the minimum lease payments. Lease payments are apportioned between finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability.

A leased asset is depreciated over the useful life of the asset. However, if there is no reasonable certainty that the Group will obtain ownership by the end of the lease term, the asset is depreciated over the shorter of the estimated useful life of the asset and the lease term.

8.6.1.2 Finance leases – Group as a lessor

When the Group is the lessor under a lease agreement that transfers substantially all of the risks and rewards incidental to the ownership of the asset to the lessee, the net investment in lease (i.e., after deduction of unearned charges) are included in "loans and advances to banks" or "loans and advances to other customers", as appropriate. The finance income receivable is recognised in "interest income" over the periods of the leases so as to achieve a constant rate of return on the net investment in the leases.

8.6.2 Operating leases

8.6.2.1 Operating leases – group as a lessee

Assets held under leases other than finance leases are classified as operating leases and are not recognised in the Group's SOFP. Payments made under operating leases are recognised in profit or loss on a straight-line basis over the term of the lease. Lease incentives received are recognised as an integral part of the total lease expense, over the term of the lease. Contingent rental payable is recognised as an expense in the period in which they are incurred.

8.6.2.2 Operating leases – Group as a lessor

Assets leased under leases other than finance leases are classified as operating leases. Initial direct costs incurred in negotiating operating leases are added to the carrying amount of the leased asset and recognised over the lease term on the same basis as rental income.

Contingent rents are recognised as revenue in the period in which they are earned.

Details of "Operating leases" are given in Note 68 on page 318.

8.7 Rental income and expenses

Rental income and expense are recognised in profit or loss on an accrual basis.

9. Significant accounting policies – income tax expense

9.1 Current tax

Details of "Income tax expense" are given in Note 24 on pages 216 to 218.

9.2 Deferred tax

Details of "Deferred tax assets and liabilities" are given in Note 43 on pages 275 to 277.

9.3 Tax exposures

In determining the amount of current and deferred tax, the Group considers the impact of tax exposures, including whether additional taxes and penalties are due. Finalisation of the tax liability with authorities may change the position already recorded in the Financial Statements and such changes to tax liabilities could impact the tax expense in the period in which such a determination is made either as an over or under provision.

9.4 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 April 1, 2013 and is payable to the National Insurance Trust Fund. Currently, the CIL is payable at 1% of the profit after tax.

9.5 Withholding tax on dividends distributed by the Bank, subsidiaries and associates

9.5.1 Withholding tax on dividends distributed by the Bank

Withholding tax that arises from the distribution of dividends by the Bank is recognised at the time the liability to pay the related dividend is recognised.

9.5.2 Withholding tax on dividends distributed by the subsidiaries and associates

Dividends received by the Bank from its subsidiaries and associates, have attracted a 14% deduction at source after April 1, 2018. (10% up to March 31, 2018)

9.6 Economic Service Charge (ESC)

As per the provisions of the Finance Act No. 11 of 2004, and amendments thereto, the ESC was introduced with effect from April 1, 2004. Currently, the ESC is payable at 0.5% of the total 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 three subsequent years including the current year of assessment.

9.7 Value Added Tax (VAT) on financial services

The value additional attributable to the supply of financial services is calculated by adjusting the economic depreciation computed on rates prescribed by the Department of Inland Revenue to the accounting profit before income tax and emoluments payable. Emoluments payable include benefits in money and not in money including contribution or provision relating to terminal benefits.

The amount of VAT charged in determining the profit or loss for the period is given in Note 23 on page 215.

9.8 Nation Building Tax (NBT) on financial services

With effect from January 1, 2014, NBT of 2% was introduced on supply of financial services via an amendment to the NBT Act No. 9 of 2009. NBT is chargeable on the same base used for calculation of VAT on financial services as explained in Note 9.7 above.

The amount of NBT charged in determining the profit or loss for the period is given in Note 23 on page 215.

9.9 Debt Repayment Levy (DRL) on financial services

As per the Finance Act No. 35 of 2018, with effect from October 1, 2018, DRL of 7% was introduced on the value addition attributable to the supply of financial services by each financial institution. DRL is chargeable on the same base used for calculation of VAT on financial services as explained in Note 9.7 above.

The amount of DRL charged in determining the profit or loss for the period is given in Note 23 on page 215.

10. Significant accounting policies – Statement of cash flows

10.1 Statement of cash flows

The Statement of Cash Flows is prepared using the "Indirect Method" of preparing cash flows in accordance with the Sri Lanka Accounting Standard – LKAS 7 on "Statement of Cash Flows" (LKAS 7). Cash and cash equivalents comprise of short-term, highly liquid investments that are readily convertible to known amounts cash and are subject to an insignificant risk of changes in value. Gross cash and cash equivalents as referred to in the Statement of Cash Flows are comprised those items as explained in Note 29 on page 231.

The Statement of Cash Flows is given on page 168.

11. New accounting standards issued but not yet effective

Sri Lanka Accounting Standard – SLFRS 16 "Leases" (SLFRS 16) which has been issued but not yet effective as at the reporting date, has not been applied in preparing these Consolidated Financial Statements. The Group plans to apply this standard on the respective effective date:

The details are given in the Table below.

Table – 37

Accounting standard	Summary of the requirements	Possible impact on Consolidated Financial Statements
SLFRS 16 – "Leases"	SLFRS 16 eliminates the current dual accounting model for lessees which distinguishes between on-balance sheet finance leases and off-balance sheet operating leases. Instead there will be a single on-balance sheet accounting model that is similar to current finance lease accounting. SLFRS 16 is effective for annual reporting periods beginning on or after January 1, 2019.	The Group and the Bank are assessing the potential impact on its Financial Statements resulting from the application of SLFRS 16, based on operating leases set-out in Note 68 on page 318.

12. Transition disclosures

12.1 Reconciliation between the carrying amounts under LKAS 39 to the balances reported under SLFRS 9 as at January 1, 2018

12.1 (a) Group

Description	Note	LKAS 39 Measurement as at December 31, 2017	
		Category	Rs '000
Financial assets			
Cash and cash equivalents		Loans and receivables	34,673,424
Balances with central banks		Loans and receivables	45,546,349
Placements with banks		Loans and receivables	17,633,269
Securities purchased under resale agreements		Loans and receivables	–
Financial assets at amortised cost – Loans and advances to banks		Loans and receivables	640,512
Financial assets at amortised cost – Loans and advances to other customers		Loans and receivables	742,444,130
Financial assets at amortised cost – Debt and other financial instruments		N/A	–
From: Financial Investments – Loans and receivables	(i)		
From: Financial Investments – Held to maturity	(ii)		
Financial investments – Loans and receivables		Loans and receivables	48,712,477
To: Financial assets at amortised cost	(i)		
To: Financial assets measured at fair value through other comprehensive income	(iii)		
		Total loans and receivables	**889,650,161**
Financial investments – Available for sale		Available for sale	154,913,643
To: Financial assets measured at fair value through other comprehensive income	(iv)		–
To: Financial assets recognised through profit or loss	(v)		–
		Total available for sale	**154,913,643**
Financial investments – Held to maturity		Held to maturity	69,365,796
To: Financial assets at amortised cost – Debt and other financial instruments	(ii)		
		Total held to maturity	**69,365,796**
Financial assets measured at fair value through other comprehensive income		N/A	–
From: Financial investments – Available for sale	(iv)		–
From: Financial investments – Loans and receivables	(iii)		–
		N/A	–
Derivative financial assets		Fair value through profit or loss	2,334,536
Financial assets recognised through profit or loss/Held for trading		Fair value through profit or loss	4,410,913
From: Financial investments – Available for sale	(v)		–
		Total fair value through profit or loss	**6,745,449**
Total financial assets			**1,120,675,049**
Total assets subject to transition impact			**1,120,675,049**
Financial liabilities			
Due to banks		Financial liabilities at amortised cost	60,244,892
Securities sold under repurchase agreements		Financial liabilities at amortised cost	49,532,385
Financial liabilities at amortised cost – Due to depositors		Financial liabilities at amortised cost	857,269,981
Financial liabilities at amortised cost – Other borrowings		Financial liabilities at amortised cost	23,786,094
Subordinated liabilities		Financial liabilities at amortised cost	25,165,924
		Total amortised cost	**1,015,999,276**
Derivative financial liabilities		Fair value through profit or loss	3,678,494
Financial liabilities recognised through profit or loss – Measured at fair value		Fair value through profit or loss	–
		Total fair value through profit or loss	**3,678,494**
Total financial liabilities			**1,019,677,770**
Non-financial liabilities			
Deferred tax liabilities	(vi)	N/A	3,565,215
Other liabilities	(vii)	N/A	19,508,115
Total non-financial liabilities			**23,073,330**
Total liabilities subject to transition impact			**1,042,751,100**

	Remeasurement		SLFRS 9 Measurement as at January 1, 2018	
Reclassification	ECL	Other	Rs '000	Category
–	(5,286)	–	34,668,138	Financial assets at amortised cost
–	–	–	45,546,349	Financial assets at amortised cost
–	(31,533)	–	17,601,736	Financial assets at amortised cost
–	–	–	–	Financial assets at amortised cost
–	(139)	–	640,373	Financial assets at amortised cost
–	(4,600,816)	–	737,843,314	Financial assets at amortised cost
77,511,571	(69,680)	–	77,441,891	Financial assets at amortised cost
8,145,775	(3,524)	–		
69,365,796	(66,156)	–		
(48,712,477)	–	–	–	N/A
(8,145,775)	–	–		
(40,566,702)	–	–		
28,799,094	**(4,707,454)**	**–**	**913,741,801**	**Total financial assets at amortised cost**
(154,913,643)	–	–		N/A
(154,573,461)	–	–		
(340,182)	–	–		
(154,913,643)	**–**	**–**		**N/A**
(69,365,796)	–	–		N/A
(69,365,796)				
(69,365,796)	–	–		**N/A**
195,140,163	–	(11,294)	195,128,869	Financial assets measured at fair value through other comprehensive income
154,573,461	–	–		
40,566,702	–	(11,294)		
195,140,163	**–**	**(11,294)**	**195,128,869**	**Total financial assets measured at fair value through other comprehensive income**
–	–	–	2,334,536	Fair value through profit or loss
340,182	–	–	4,751,095	Fair value through profit or loss
340,182				
340,182	**–**	**–**	**7,085,631**	**Total Fair value through profit or loss**
–	**(4,707,454)**	**(11,294)**	**1,115,956,301**	
–	**(4,707,454)**	**(11,294)**	**1,115,956,301**	
–	–	–	60,244,892	Financial liabilities at amortised cost
–	–	–	49,532,385	Financial liabilities at amortised cost
–	–	–	857,269,981	Financial liabilities at amortised cost
–	–	–	23,786,094	Financial liabilities at amortised cost
–	–	–	25,165,924	Financial liabilities at amortised cost
–	**–**	**–**	**1,015,999,276**	**Total amortised cost**
–	–	–	3,678,494	Fair value through profit or loss
–	–	–	–	Fair value through profit or loss
–	**–**	**–**	**3,678,494**	**Total fair value through profit or loss**
–	**–**	**–**	**1,019,677,770**	
–	–	(1,807,488)	1,757,727	N/A
–	847,659	–	20,355,774	N/A
–	**847,659**	**(1,807,488)**	**22,113,501**	
–	**847,659**	**(1,807,488)**	**1,041,791,271**	

Notes

(i) As at January 1, 2018, the Group has classified financial investments – loans and receivables (other than those described in Note iii) into amortised cost since these assets are managed within a business model of collecting contractual cash flows.

(ii) As at January 1, 2018, the Group did not have any debt instruments that did not meet the SPPI criterion within its held-to-maturity portfolio. Therefore, it elected to classify all of these instruments as debt instruments measured at amortised cost.

(iii) As at January 1, 2018, the Group has classified investments in Sri Lanka Development Bonds (SLDBs) as FVOCI Investments, as these instruments are managed within a business model of collecting contractual cash flows and selling. These investments were previously classified under loans and receivables as per LKAS 39. The remeasurement impact on these SLDBs at fair value amounted to a loss of Rs. 11.294 Mn.

(iv) As at January 1, 2018, the Group has assessed its Government Securities held for liquidity purposes under AFS amounting to Rs. 154,366.556 Mn. and classified into debt instruments measured at FVOCI as these are managed within a business model of collecting contractual cash flows and selling. In addition the Group has elected the option to irrevocably designate its previous AFS equity instruments amounting to Rs. 206.905 Mn. as Equity instruments at FVOCI.

(V) As at January 1, 2018, the Group has classified its "VISA Inc" Shares to FVTPL from AFS, as they are neither held for trading nor designated at FVOCI.

(vi) The net decrease in deferred tax liabilities was due to impact that arose from expected credit loss and remeasurement of SLDB investments at fair value.

(vii) The increase in other liabilities was due to the inclusion of expected credit loss related to contingent liabilities and commitments.

12.1 (b) Bank

Description	Note	LKAS 39 Measurement as at December 31, 2017 Category	Rs '000
Financial assets			
Cash and cash equivalents		Loans and receivables	33,224,619
Balances with central banks		Loans and receivables	44,801,446
Placements with banks		Loans and receivables	17,633,269
Securities purchased under resale agreements		Loans and receivables	–
Financial assets at amortised cost – Loans and advances to banks		Loans and receivables	640,512
Financial assets at amortised cost – Loans and advances to other customers		Loans and receivables	737,446,567
Financial assets at amortised cost – Debt and other financial instruments		N/A	–
From: Financial investments – Loans and receivables	(i)		–
From: Financial investments – Held to maturity	(ii)		–
Financial investments – Loans and receivables		Loans and receivables	48,712,477
To: Financial assets at amortised cost	(i)		
To: Financial assets measured at fair value through other comprehensive income	(iii)		
		Total loans and receivables	**882,458,890**
Financial investments – Available for sale		Available for sale	154,714,132
To: Financial assets measured at fair value through other comprehensive income	(iv)		–
To: Financial assets recognised through profit or loss	(v)		–
		Total available for Sale	**154,714,132**
Financial investments – Held to maturity		Held to maturity	63,562,752
To: Financial assets at amortised cost – Debt and other financial instruments	(ii)		–
		Total Held to maturity	**63,562,752**
Financial assets measured at fair value through other comprehensive income		N/A	–
From: Financial investments – Available for sale	(iv)		–
From: Financial investments – Loans and receivables	(iii)		–
		N/A	–
Derivative financial assets		Fair value through profit or loss	2,334,536
Financial assets recognised through profit or loss/held for trading		Fair value through profit or loss	4,410,913
From: Financial investments – Available for sale	(v)		
		Total fair value through profit or loss	**6,745,449**
Total Financial assets			**1,107,481,223**
Total assets subject to transition impact			**1,107,481,223**
Financial liabilities			
Due to banks		Financial liabilities at amortised cost	57,120,991
Securities sold under repurchase agreements		Financial liabilities at amortised cost	49,676,767
Financial liabilities at amortised cost – Due to depositors		Financial liabilities at amortised cost	850,127,511
Financial liabilities at amortised cost – Other borrowings		Financial liabilities at amortised cost	23,786,094
Subordinated liabilities		Financial liabilities at amortised cost	25,165,924
		Total amortised cost	**1,005,877,287**
Derivative financial liabilities		Fair value through profit or loss	3,678,494
Financial liabilities recognised through profit or loss – Measured at fair value		Fair value through profit or loss	–
		Total fair value through profit or loss	**3,678,494**
Total financial liabilities			**1,009,555,781**
Non-financial liabilities			
Deferred tax liabilities	(vi)	N/A	3,274,826
Other liabilities	(vii)	N/A	19,225,364
Total non-financial liabilities			**22,500,190**
Total liabilities subject to transition impact			**1,032,055,971**

	Remeasurement		SLFRS 9 Measurement as at January 1, 2018	
Reclassification	ECL	Other	Rs '000	Category
–	(5,286)	–	33,219,333	Financial assets at amortised cost
–	–	–	44,801,446	Financial assets at amortised cost
–	(31,533)	–	17,601,736	Financial assets at amortised cost
–	–	–	–	Financial assets at amortised cost
–	(139)	–	640,373	Financial assets at amortised cost
–	(4,157,005)	–	733,289,562	Financial assets at amortised cost
71,708,527	(69,680)	–	71,638,847	Financial assets at amortised cost
8,145,775	(3,524)	–	–	
63,562,752	(66,156)	–	–	
(48,712,477)	–	–	–	N/A
(8,145,775)	–	–	–	
(40,566,702)	–	–	–	
22,996,050	**(4,263,643)**	–	**901,191,297**	**Total financial assets at amortised cost**
(154,714,132)	–	–	–	N/A
(154,373,950)	–	–	–	
(340,182)	–	–	–	
(154,714,132)	–	–	–	**N/A**
(63,562,752)	–	–	–	N/A
(63,562,752)	–	–	–	
(63,562,752)	–	–	–	**N/A**
194,940,652	–	(11,294)	194,929,358	Financial assets measured at fair value through other comprehensive income
154,373,950	–	–	–	
40,566,702	–	(11,294)	–	
194,940,652	–	(11,294)	194,929,358	**Total Financial assets measured at fair value through other comprehensive income**
	–	–	2,334,536	Fair value through profit or loss
340,182	–	–	4,751,095	Fair value through profit or loss
340,182	–	–	–	
340,182	–	–	**7,085,631**	**Total fair value through profit or loss**
–	**(4,263,643)**	**(11,294)**	**1,103,206,286**	
–	**(4,263,643)**	**(11,294)**	**1,103,206,286**	
–	–	–	57,120,991	Financial liabilities at amortised cost
–	–	–	49,676,767	Financial liabilities at amortised cost
–	–	–	850,127,511	Financial liabilities at amortised cost
–	–	–	23,786,094	Financial liabilities at amortised cost
–	–	–	25,165,924	Financial liabilities at amortised cost
–	–	–	**1,005,877,287**	**Total amortised cost**
–	–	–	3,678,494	Fair value through profit or loss
–	–	–	–	Fair value through profit or loss
–	–	–	**3,678,494**	**Total fair value through profit or loss**
–	–	–	**1,009,555,781**	
–	–	(1,682,581)	1,592,245	N/A
–	847,659	–	20,073,023	N/A
–	**847,659**	**(1,682,581)**	**21,665,268**	
	847,659	**(1,682,581)**	**1,031,221,049**	

Notes

(i) As at January 1, 2018, the Bank has classified financial investments- loans and receivables (other than those described in Note iii) into amortised cost since these assets are managed within a business model of collecting contractual cash flows.

(ii) As at January 1, 2018, the Bank did not have any debt instruments that did not meet the SPPI criterion within its held-to-maturity portfolio. Therefore, it elected to classify all of these instruments as debt instruments measured at amortised cost.

(iii) As at January 1, 2018, the Bank has classified investments in Sri Lanka Development Bond (SLDB) as FVOCI Investments, as these instruments are managed within a business model of collecting contractual cash flows and selling. These investments were previously classified under loans and receivables as per LKAS 39. The remeasurement impact on these SLDBs at fair value amounted to a loss of Rs. 11.294 Mn.

(iv) As at January 1, 2018, the Bank has assessed its Government securities held for liquidity purposes under AFS amounting to Rs. 154,167.169 Mn. and classified into debt instruments measured at FVOCI as these are managed within a business model of collecting contractual cash flows and selling. In addition the Bank has elected the option to irrevocably designate its previous AFS equity instruments amounting to Rs. 206.781 Mn. as Equity instruments at FVOCI.

(v) As at January 1, 2018, the Bank has classified its "VISA Inc" Shares to FVTPL from AFS, as they are neither held to trading nor designated at FVOCI.

(vi) The net decrease in deferred tax liabilities was due to impact that arose from expected credit loss and remeasurement of SLDB investments at fair value.

(vii) The increase in other liabilities was due to the inclusion of expected credit loss related to contingent liabilities and commitments.

12.2 Impact of transition to SLFRS 9 on reserves and retained earnings

	Note	Page No.	GROUP Rs. '000	BANK Rs. '000
Fair value reserve				
Closing balance under LKAS 39 as at December 31, 2017 (A)			–	–
Recognition of Expected Credit Loss (ECL) under SLFRS 9 for debt financial assets at FVOCI			194,256	194,256
Remeasurement impact of reclassifying financial investment from L&R to FVOCI			(11,294)	(11,294)
Deferred tax on Transitional adjustments			(47,775)	(47,775)
Transfer of AFS reserve to fair value reserve			(460,599)	(460,607)
Opening balance under SLFRS 9 as at January 1, 2018 (B)			(325,412)	(325,420)
Impact of adoption of SLFRS 9 on fair value reserve (C=B-A)			**(325,412)**	**(325,420)**
Available-for-sale reserve				
Closing balance under LKAS 39 as at December 31, 2017 (D)			(1,707,486)	(1,707,494)
Transfer of AFS reserve build o/a reclassification of AFS portfolio to HTM portfolio			1,587,069	1,587,069
Impact of reclassifying financial investment from AFS to FVTPL			(340,182)	(340,182)
Transfer of AFS reserve to fair value reserve			460,599	460,607
Opening balance under SLFRS 9 as at January 1, 2018 (E)			–	–
Impact of adoption of SLFRS 9 on Available for reserve (F=E-D)			**1,707,486**	**1,707,494**
Retained earnings				
Closing balance under LKAS 39 as at December 31, 2017 (G)			5,086,609	4,987,446
Recognition of SLFRS 9 ECLs including those measured at FVOCI	12.3	201	(5,749,369)	(5,305,558)
Deferred tax in relation to ECL			1,855,263	1,730,356
Transfer of AFS reserve build o/a reclassification of AFS portfolio to HTM portfolio			(1,587,069)	(1,587,069)
Impact of reclassifying financial investment from AFS to FVTPL			340,182	340,182
Opening balance under SLFRS 9 as at January 1, 2018 (H)			(54,384)	165,357
Impact of adoption of SLFRS 9 on retained earnings (I=H-G)			**(5,140,993)**	**(4,822,089)**
Total change in equity due to adopting SLFRS 9 (C+F+I)			**(3,758,919)**	**(3,440,015)**

12.3 Impact of transition to SLFRS 9 on impairment

The following sub notes provide a reconciliation on the aggregate opening provision for impairment under LKAS 39 and provision for loan commitments and financial guarantee contracts in accordance with Sri Lanka Accounting Standard – LKAS 37 on "Provisions Contingent Liabilities and Contingent Assets" (LKAS 37) to the ECL allowances under SLFRS 9. Further details are disclosed in Notes 29-31, 34-37 and 59 on pages 231 to 233, 238 to 254 and 303.

12.3 (a) Group

	Impairment under LKAS 39/ LKAS 37 as at December 31, 2017 Rs. '000	Remeasurement Rs. '000	**ECLs under SLFRS 9 as at January 1, 2018 Rs. '000**
Impairment allowance for loans and receivables and held-to-maturity investments as per LKAS 39/financial assets at amortised cost under SLFRS 9	18,009,807	4,707,454	**22,717,261**
Available-for-sale debt investment securities as per LKAS 39/debt financial assets at FVOCI under SLFRS 9	–	12,339	**12,339**
Financial investments loans and receivables as per LKAS 39/debt financial assets at FVOCI under SLFRS 9	–	181,917	**181,917**
	18,009,807	4,901,710	**22,911,517**
Letters of credit for customers	–	120,546	**120,546**
Loans and other commitments	–	727,113	**727,113**
	–	847,659	**847,659**
Total impairment	**18,009,807**	**5,749,369**	**23,759,176**

12.3 (b) Bank

	Impairment under LKAS 39/ LKAS 37 as at December 31, 2017 Rs. '000	Remeasurement Rs. '000	**ECLs under SLFRS 9 as at January 1, 2018 Rs. '000**
Impairment allowance for loans and receivables and held-to-maturity investments as per LKAS 39/financial assets at amortised cost under SLFRS 9	17,261,410	4,263,643	**21,525,053**
Available-for-sale debt investment securities as per LKAS 39/debt financial assets at FVOCI under SLFRS 9	-	12,339	**12,339**
Financial investments loans and receivables as per LKAS 39/debt financial assets at FVOCI under SLFRS 9	-	181,917	**181,917**
	17,261,410	4,457,899	**21,719,309**
Letters of credit for customers	–	120,546	**120,546**
Loans and other commitments	–	727,113	**727,113**
	–	847,659	**847,659**
Total impairment	**17,261,410**	**5,305,558**	**22,566,968**