MCB BANK LIMITED – SRI LANKA BRANCH

FINANCIAL STATEMENTS
FOR THE YEAR ENDED
31 DECEMBER 2017

KPMG
(Chartered Accountants)
32A, Sir Mohamed Macan Markar Mawatha,
P. O. Box 186,
Colombo 00300, Sri Lanka.

Tel : +94 - 11 542 6426
Fax : +94 - 11 244 5872
+94 - 11 244 6058
+94 - 11 254 1249
Internet : www.kpmg.com/lk

INDEPENDENT AUDITORS' REPORT

TO THE MANAGEMENT OF MCB BANK LIMITED – SRI LANKA BRANCH

Report on the Financial Statements

We have audited the accompanying financial statements of MCB Bank Limited – Sri Lanka Branch ("the Bank") which comprise the statement of financial position as at December 31, 2017, and the statements of profit or loss and other comprehensive income, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Sri Lanka Auditing Standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by Management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the Bank as at December 31, 2017, and of its financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

KPMG

CHARTERED ACCOUNTANTS
Colombo
28th March 2018

MCB BANK LIMITED - SRI LANKA BRANCH

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

For the year ended 31 December *All amounts in Sri Lankan Rupees*	Note	2017	2016
Interest Income		2,611,729,936	1,868,345,331
Interest Expenses		(1,216,619,735)	(759,191,301)
Net Interest Income	7	1,395,110,201	1,109,154,030
Fee and Commission Income	8	126,357,870	119,140,738
Other Operating Income	9	99,018,288	73,284,414
Total Operating Income		1,620,486,359	1,301,579,182
Impairment charges for Loans and Other Losses	10	(142,651,780)	(51,486,604)
Net Operating Income		1,477,834,579	1,250,092,578
Personnel Expenses	11	(283,256,405)	(259,256,257)
Other Expenses	12	(325,372,466)	(267,274,576)
Operating Profit Before Value Added Tax		869,205,708	723,561,745
Value Added Tax on Financial Services		(156,996,310)	(104,243,294)
Profit Before Income Tax		712,209,398	619,318,451
Tax Expense	13	(208,522,813)	(180,246,868)
Profit for the Year		503,686,585	439,071,583
Other Comprehensive Income, Net of Tax			
Actuarial Gain / (Loss) on Defined Benefit Plans	28.i.a	(4,069,069)	(5,036,635)
Deferred Tax effect on actuarial gain / (loss)		270,918	220,283
Foreign currency translation reserve			
- Gain/(Loss) on translation of FCBU		14,217,006	19,403,951
Net Change in Fair Value of Available-for-Sale Financial Assets (Net of tax)		8,041,740	5,738,045
Surplus from revaluation of Property, plant & equipment		22,638,878	-
Deferred Tax effect on above Surplus from revaluation of Property, plant & equipment		(6,338,888)	-
Other Comprehensive Income for the Year, net of Tax		34,760,585	20,325,644
Total Comprehensive Income for the Year		538,447,170	459,397,227

The notes to the financial statements are an integral part of these financial statements.

MCB BANK LIMITED - SRI LANKA BRANCH

STATEMENT OF FINANCIAL POSITION

As at 31 December
All amounts in Sri Lankan Rupees

	Note	2017	2016
ASSETS			
Cash and Cash Equivalents	14	197,471,794	203,475,398
Balances with Central Banks	15	2,112,481,798	1,582,860,800
Placements with Banks	16	873,777,231	1,570,648,609
Derivative Financial Instruments	17	1,503,642	10,387,471
Loans and Advances to customers	18	20,239,109,921	15,406,837,505
Financial Investments – Available-for-Sale	19	3,251,973,694	1,075,960,805
Financial Investments – Held-to-Maturity	20	1,746,095,812	2,930,674,932
Property, Plant and Equipment	21	245,167,884	160,978,608
Intangible Assets	22	47,391,656	22,718,502
Other Assets	23	115,762,283	139,737,169
Total Assets		28,830,735,715	23,104,279,799
LIABILITIES			
Due to Banks	24	3,337,142,730	2,458,866,567
Derivative Financial Instruments	17	87,163,711	549,854
Deposits from customers	25	18,670,299,972	14,195,492,808
Other Borrowings	26	99,175,221	70,777,753
Current Tax Liabilities		106,453,518	115,962,120
Deferred Tax Liabilities	27	37,360,954	25,306,986
Other Liabilities	28	465,589,327	598,936,261
Total Liabilities		22,803,185,433	17,465,892,349
EQUITY			
Assigned Capital	29	3,969,508,163	3,969,508,163
Statutory Reserve Fund	30	192,003,088	166,818,759
Retained Earnings		1,697,578,877	1,372,159,109
Other Reserves		168,460,154	129,901,419
Total Equity		6,027,550,282	5,638,387,450
Total Equity and Liabilities		28,830,735,715	23,104,279,799
Commitments and Contingencies	31	16,096,713,583	13,238,865,227

The notes to the financial statements are an integral part of these financial statements.

The Management is responsible for the preparation and presentation of these financial statements.
Signed for and on behalf of the Management by:

Apiramy Jeyarajah
Department Head - Finance

Bandula Herath
Assistant General Manager

Aali Shafi
Country General Manager

28 March 2018
Colombo

MCB BANK LIMITED

STATEMENT OF CHANGES IN EQUITY

All amounts in Sri Lankan Rupees

	Assigned capital	Reserve Fund	Revaluation reserves	Available for Sale Reserve	Retained Earnings	Foreign currency translation reserve	Total
Balance as at 1st January 2016	3,969,508,163	144,865,180	41,576,374	(3,290,921)	1,062,061,867	66,473,970	5,281,194,633
Net Profit for the year	-	-	-	-	439,071,583	-	439,071,583
Other comprehensive income	-	-	-	5,738,045	(5,036,635)	19,403,951	20,105,361
Deferred Tax effect on other comprehensive income	-	-	-		220,284	-	220,284
Total comprehensive income for the year	-	-	-	5,738,045	434,255,232	19,403,951	459,397,227
Transactions with Equity Holders recognized directly in Equity							
Transfers to Statutory Reserve	-	21,953,579	-	-	(21,953,579)		-
Profit transferred to head office	-	-	-	-	(102,204,411)	-	(102,204,411)
Total transactions with equity holders	-	21,953,579	-	-	(124,157,990)	-	(102,204,411)
Balance as at 31 December 2016	3,969,508,163	166,818,759	41,576,374	2,447,124	1,372,159,109	85,877,921	5,638,387,450
Balance as at 1st January 2017	3,969,508,163	166,818,759	41,576,374	2,447,124	1,372,159,109	85,877,921	5,638,387,450
Net Profit for the year	-	-	-	-	503,686,585	-	503,686,585
Other comprehensive income			22,638,878	11,169,083	(4,069,069)	14,217,006	43,955,898
Deferred Tax effect on other comprehensive income	-	-	(6,338,888)	(3,127,343)	270,918	-	(9,195,313)
Total comprehensive income for the year	-	-	16,299,990	8,041,740	499,888,434	14,217,006	538,447,170
Transactions with Equity Holders recognized directly in Equity							
Transfers to Statutory Reserve	-	25,184,329	-	-	(25,184,329)		-
Profit transferred to head office	-	-	-	-	(149,284,338)	-	(149,284,338)
Total transactions with equity holders	-	25,184,329	-	-	(174,468,667)	-	(149,284,338)
Balance as at 31st December 2017	3,969,508,163	192,003,088	57,876,364	10,488,864	1,697,578,877	100,094,926	6,027,550,282

The notes to the financial statements are an integral part of these financial statements

MCB BANK LIMITED - SRI LANKA BRANCH

CASH FLOW STATEMENT

For the year ended 31 December *All amounts in Sri Lankan Rupees*	2017	2016
Cash Flows From Operating Activities		
Interest and commission receipts	2,664,311,998	1,973,991,531
Interest payments	(934,781,020)	(732,214,054)
Cash payments from other operating activities	61,793,309	73,224,434
Cash payments to employees and suppliers	(707,032,442)	(596,285,964)
Operating profit before changes in Operating Assets and Liabilities (Note A)	1,084,291,845	718,715,947
Increase in Operating Assets		
Deposits held for Regulatory or Monetary Control Purposes	(529,620,998)	(351,130,334)
Funds Advanced to Customers	(4,894,342,976)	(2,794,209,221)
Other Short term Assets	32,858,715	(26,939,903)
Increase/(Decrease) in Operating Liabilities		
Deposits from customers	4,212,072,620	2,493,801,725
Other Liabilities	(41,222,010)	18,587,535
Net Cash Generated from Operations	(135,962,803)	58,825,751
Income Tax Paid	(212,045,417)	(72,460,783)
Net Cash flows generated from / (used in) Operating Activities	(348,008,220)	(13,635,032)
Cash Flows from Investing Activities		
Net proceeds from maturity and purchase of Financial Investments	(947,351,790)	3,077,643,898
Proceed from maturity of other Placements with Banks	691,133,552	(171,092,182)
Purchase of Property, Plant and Equipment	(140,198,304)	(23,621,948)
Proceeds from Sale of Property, Plant and Equipment	136,035	59,998
Net Cash Flows generated from / (used in) Investing Activities	(396,280,507)	2,882,989,766
Cash flow from Financing Activities		
Capital Infusion from Head Office	-	-
Profit repatriation to Head Office	(149,284,338)	(102,204,411)
Increase/(Decrease) of borrowings	887,569,461	(2,801,568,847)
Net cash generated from /(used in) financing Activities	738,285,123	(2,903,773,258)
Net Increase in Cash and Cash Equivalents	(6,003,604)	(34,418,524)
Cash and Cash Equivalents at the Beginning of the year	203,475,398	237,893,922
Cash and Cash Equivalents at the End of the year (Note 14)	197,471,794	203,475,398

The notes to the financial statements are an integral part of these financial statements.

CASH FLOW STATEMENT

For the year ended 31 December	2017	2016
All amounts in Sri Lankan Rupees		
Note A		
Reconciliation of operating profit before changes in operating assets and liabilities		
Profit before Income Tax Expense	712,209,398	619,318,451
Adjustments for :		
Impairment charges for loans and other losses	142,651,780	51,486,604
Amortisation of intangible assets	14,464,509	7,154,002
Depreciation of Property, Plant and Equipment	39,491,361	22,700,508
Profit on sale of Property, Plant and Equipment	(117,159)	(59,980)
Loss/ (Gain) on sale of securities	(37,107,820)	
Provision for employee benefit	14,326,165	12,025,238
Payment for employee benefit	(9,689,296)	(7,391,585)
Accrual for interest receivable	(73,775,808)	(13,494,538)
Accrual for interest payable	281,838,715	26,977,247
Operating profit before changes in operating assets and liabilities	1,084,291,845	718,715,947

The notes to the financial statements are an integral part of these financial statements.

1. REPORTING ENTITY

MCB Bank Limited-Sri Lanka Branch (the "Bank") is a foreign branch of MCB Bank Limited, incorporated in Pakistan and commenced its business in 1994. The bank was approved to carry out both domestic and off-shore banking under the Banking Act 30 of 1988 and amendments thereto. The registered office of the bank is located at No.8, Leyden Bastian Road, York Arcade Building, Colombo 01.

1.1 Principal Activities and Nature of Operations

Principal activities of the Bank continued to be banking and related activities such as accepting deposits, corporate and retail banking, off shore banking, foreign currency operations, trade services etc.

2. BASIS OF PREPARATION

2.1 Statement of Compliance

The Financial Statements of the Bank which comprise the Statement of Financial Position, Statement of Profit or Loss & Other Comprehensive Income, Statement of Changes in Equity, Statement of Cash Flows and Notes thereto have been prepared in accordance with Sri Lanka Accounting Standards (LKASs and SLFRSs) laid down by the Institute of Chartered Accountants of Sri Lanka and Banking Act No.30 of 1988 and subsequent amendments thereto.

The Bank's Financial Statements were authorized for issue by the management in accordance with the resolution of the management on 28th March 2018.

2.2 Basis of Measurement

The Financial Statements have been prepared on the historical cost basis and applied consistently, with no adjustments being made for inflationary factors affecting the Financial Statements, except for the following;

- Derivative financial instruments are measured at fair value;
- Available for sale financial assets are measured at fair value;
- Freehold land and buildings (Condominium) are measured at cost at the time of acquisition and subsequently at revalued amounts which are the fair values at the date of revaluation;
- Measurement of defined benefit obligations: are measured at present value of obligation

2.3 Functional and Presentation Currency

Financial Statements are presented in Sri Lankan Rupees, which is the Bank's functional currency. All amounts have been rounded to the nearest Rupee, except when otherwise indicated.

2.4 Use of Estimates and Judgments

The preparation of the Financial Statements in conformity with Sri Lanka Accounting Standards requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expense. Actual amount may defer from these estimates.

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

Information about significant areas of estimation uncertainty and critical judgments in applying accounting policies that have the most significant effect on the amounts recognized in the Financial Statements are described in the relevant notes as follows.

- Note 3.9 - Recognition, classification and measurement of financial instruments
- Note 3.9.10 - Identification, measurement and assessment of impairment of financial assets
- Note 3.15 - Impairment of non-financial assets
- Note 28.1 - Employee retirement benefits
- Note 27 - Deferred taxation
- Note 21 - Revaluation of land and building

An analysis of financial instruments measured at fair value as at the end of the reporting period, by the level of the fair value hierarchy is given in Note 33.

2.5 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.

3. SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below have been applied consistently to periods presented in these Financial Statements, unless otherwise indicated.

3.1 Foreign Currency - Foreign currency transactions

Transactions in foreign currencies are translated into the respective functional currency of the Bank at the spot exchange rates at the dates of the transactions.

Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated into the functional currency at the spot exchange rate at that date.

Non-monetary assets and liabilities that are measured at fair value in a foreign currency are translated into the functional currency at the spot exchange rate at the date on which the fair value is determined. Non-monetary items that are measured based on historical cost in a foreign currency are translated using the spot exchange rate at the date of the transaction. Forward foreign exchange contracts and currency swaps are valued at the forward market rate ruling on the date of the Statement of Financial Position.

Unrealized foreign exchange gains and losses are recognized under 'Other Operating Income' in profit or loss.

3.2 Interest

Interest income and expense are recognized in profit or loss using the effective interest method. The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or liability (or, where appropriate, a shorter period) to the carrying amount of the financial asset or liability. When calculating the effective interest rate, the Bank estimates future cash flows considering all contractual terms of the financial instrument, but not future credit losses.

The calculation of the effective interest rate includes all transaction costs and fees and points paid or received that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or liability.

Interest income and expense presented in profit or loss include;

- interest on financial assets and financial liabilities measured at amortised cost calculated on an effective interest basis;
- interest income on available-for-sale investment securities calculated on an effective interest basis is also included in interest income.

3.3 Fees and commissions

Fees and commission income and expense that are integral to the effective interest rate on financial asset or liability are included in the measurement of the effective interest rate.

Other fees and commission income, including account servicing fees, Trade fees are recognised as the related services are performed. When a loan commitment is not expected to result in the draw-down of a loan, the related loan commitment fees are recognized on a straight-line basis over the commitment period. Other fees and commission expense relate mainly to transaction and service fees, which are expensed as the services are received.

3.4 Dividend Income

Dividend income is recognised in profit or loss on an accrual basis when the Bank's right to receive the dividend is established. This is usually on the ex-dividend date for quoted equity securities.

3.5 Lease Income

The excess of aggregate lease rentals receivable over the cost of the leased assets constitutes the total unearned lease income at the commencement of a lease. The unearned lease income is taken into income over the term of the lease commencing with the month in which the lease is executed in proportion to the declining receivable balance (i.e. in a manner that reflects a constant periodic rate of return on capital outstanding).

3.6 Tax Expense

Tax expense comprises current and deferred tax. Current tax and deferred tax are recognized in profit or loss except to the extent that it relates to items recognized directly in equity or in other comprehensive income.

I. Current tax

Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Provision for taxation is based on the profit for the year adjusted for taxation purposes in accordance with the provisions of the Inland Revenue Act No 10 of 2006 and the amendments thereto at the rates specified in Note 13.

II. Deferred tax

Deferred tax is recognized in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

Deferred tax assets are recognised for unused tax losses, unused tax credits and deductible temporary differences to the extent that it is probable that future taxable profits will be available against which they can be used. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date

Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities against current tax assets, and they relate to taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

Assets and Liabilities and Basis of Measurement

3.7 Cash and Cash Equivalents

'Cash and cash equivalents' include notes and coins on hand, unrestricted balances held with central banks and highly liquid financial assets with original maturities of three months or less from the date of acquisition that are subject to an insignificant risk of changes in their fair value, and are used by the Bank in the management of its short-term commitments.

3.8 Statutory Deposit with Central Banks

The Monetary Law Act requires that all Commercial Banks operating in Sri Lanka maintain reserves against all deposit liabilities denominated in Sri Lankan Rupees. The details of reserve requirements are given in Note 15 to the financial statements.

3.9 Financial Assets and Financial Liabilities

3.9.1 Initial Recognition and Measurement

The Bank initially recognizes loans and advances, deposits, debt securities issued and subordinated liabilities on the date at which they are originated. All other financial assets and liabilities (including assets and liabilities designated at fair value through profit or loss) are initially recognized on the trade date at which the Bank becomes a party to the contractual provisions of the instrument.

A financial asset or financial liability is measured initially at fair value plus, for an item not at fair value through profit or loss, transaction costs that are directly attributable to its acquisition or issue.

3.9.2 Classification and subsequent Measurement

3.9.2.1 Financial Assets

At inception, financial assets are classified in one of the following categories.

- Financial assets at fair value through profit or loss
- Loans and receivables
- Held to maturity investments
- Available for sale financial assets

3.9.2.2 Financial Liabilities

The Bank initially recognizes all financial liabilities on the date that they are originated and classifies its financial liabilities as measured at amortized cost or fair value through profit or loss.

3.9.3 Subsequent Measurement

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

3.9.3.1 Financial assets and financial liabilities at Fair Value through Profit or Loss

A financial asset or a financial liability is classified as fair value through profit or loss if it is classified as held for trading or is designated as such upon initial recognition.

The Bank has not designated any financial asset/liability upon initial recognition at fair through profit or loss as at the reporting date.

3.9.3.2 Loans and receivables

Loans and advances' are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and that the Bank does not intend to sell immediately or in the near term.

Loans and advances to banks are classified as loans and receivables. Loans and advances to customers in the Bank include:

- those classified as loans and receivables;
- finance lease receivables.

Loans and advances are initially measured at fair value plus incremental direct transaction costs, and subsequently measured at their amortised cost using the effective interest method.

Loans and advances also include finance lease receivables in which the Bank is the lessor.

3.9.3.3 Held-to-maturity investments

'Held-to-maturity investments' are non-derivative assets with fixed or determinable payments and fixed maturity that the Bank has the positive intent and ability to hold to maturity, and which are not designated as at fair value through profit or loss or as available-for-sale.

Held-to-maturity investments are carried at amortised cost using the effective interest method, less any impairment losses. A sale or reclassification of a more than insignificant amount of held-to-maturity investments would result in the reclassification of all held-to-maturity investments as available-for-sale, and would prevent the Bank from classifying investment securities as held-to-maturity for the current and the following two financial years. However, sales and reclassifications in any of the following circumstances would not trigger a reclassification:

- sales or reclassifications that are so close to maturity that changes in the market rate of interest would not have a significant effect on the financial asset's fair value;
- sales or reclassifications after the Bank has collected substantially all of the asset's original principal; and
- sales or reclassifications that are attributable to non-recurring isolated events beyond the Bank's control that could not have been reasonably anticipated.

3.9.3.4 Available-for-sale financial investments

Available-for-sale investments are non-derivative investments that were designated as available-for-sale or are not classified as another category of financial assets. Available-for-sale investments are carried at fair value after initial recognition.

Interest income on Available-for-sale financial assets is recognised in profit or loss using the effective interest method. Dividend income is recognised in profit or loss when the Bank becomes entitled to the dividend. Foreign exchange gains or losses on Available-for-sale debt security investments are recognised in profit or loss.

Other fair value changes are recognised directly in equity through Other Comprehensive Income in the Available-for-sale Reserve until the investment is sold or impaired, whereupon the cumulative gains and losses previously recognised in Other Comprehensive Income are reclassified to profit or loss as a reclassification adjustment. The losses arising from impairment of such investments are recognised in profit or loss and removed from the Available-for-sale Reserve.

3.9.4 Amortised Cost Measurement

The amortized cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortization using the effective interest method of any difference between the initial amount recognized and the maturity amount, minus any reduction for impairment.

3.9.5 Fair Value Measurement

SLFRS 13 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transactions between market participants at the measurement date.

A Fair value measurement requires an entity to determine all the following

1. the particular asset or liability that is the subject of the measurement

2. for a non-financial asset, the valuation premise that is appropriate for the measurement (consistently with its highest and best use).

3. the principal (or most advantageous) market for the asset or liability.

4. the valuation technique(s) appropriate for the measurement, considering the availability of data with which to develop inputs that represent the assumptions that market participants would use when pricing the asset or liability and the level of the fair value hierarchy within which the inputs are categorized.

Fair value is a market-based measurement, not an entity-specific measurement. For some assets and liabilities, observable market transactions or market information might be available. For other assets and liabilities, observable market transactions and market information might not be available. However, the objective of a fair value measurement in both cases is the same to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions (i.e. an exit price at the measurement date from the perspective of a market participant that holds the asset or owes the liability).

When a price for an identical asset or liability is not observable, an entity measures fair value using another valuation technique that maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs. Because fair value is a market-based measurement, it is measured using the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk. As a result, an entity's intention to hold an asset or to settle or otherwise fulfill a liability is not relevant when measuring fair value.

When an asset is acquired or a liability is assumed in an exchange transaction for that asset or liability, the transaction price is the price paid to acquire the asset or received to assume the liability (an entry price). In contrast, the fair value of the asset or liability is the price that would be received to sell the asset or paid to transfer the liability (an exit price).

3.9.6 Determining Fair Values

The determination of fair value for financial assets and liabilities for which there is no observable market price requires the use of valuation techniques. For financial instruments that trade infrequently and have little price transparency, fair value is less objective, and requires varying degrees of judgment depending on liquidity, concentration, uncertainty of market factors, pricing assumption and other risks affecting the specific instrument.

- Level 1 - Fair value measurements using quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 - Fair value measurements using inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e.as prices) or indirectly (i.e. derived from prices); and
- Level 3 - Fair value measurements using inputs for the asset or liability that are not based on observable market data (i.e. unobservable inputs).

3.9.7 Reclassifications

Reclassifications of financial assets, other than as set out below, or of financial liabilities between measurement categories are not permitted following initial recognition.

A non-derivative financial asset Held for Trading that would have met the definition of Loans and Receivables (if the financial asset had not been required to be classified as held for trading at initial recognition) may be reclassified out of the Fair Value through Profit or Loss category, if the entity has the intention and ability to hold the financial asset for the foreseeable future or until maturity.

Financial assets are transferred out of the Available-for sale category to the Loan and Receivables category where they would have met the definition of a Loan and Receivable at the date of reclassification and the Bank has the intent and ability to hold the assets for the foreseeable future or until maturity.

Held-to-maturity assets are reclassified to the Available-for-sale category if the portfolio becomes tainted following the sale of other than an insignificant amount of Held-to-maturity assets prior to their maturity.

Financial assets are reclassified at their fair value on the date of reclassification. For financial assets reclassified out of the Available-for-sale category into Loans and Receivables, any gain or loss on those assets recognised in Shareholders' Equity prior to the date of reclassification is amortised to profit or loss over the remaining life of the financial asset, using the effective interest method.

3.9.8 De-recognition

Financial assets

The Bank derecognises a financial asset 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 of the risks and rewards of ownership of the financial asset are transferred or in which the Bank neither transfers nor retains substantially all of the risks and rewards of ownership and it does not retain control of the financial asset.

On de-recognition 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

(i) the consideration received (including any new asset obtained less any new liability assumed) and

(ii) any cumulative gain or loss that had been recognised in Other Comprehensive Income is recognised in profit or loss. Any interest in transferred financial assets that qualify for de-recognition that is created or retained by the Bank is recognised as a separate asset or liability.

The Bank enters into transactions whereby it transfers assets recognised on its statement of financial position, but retains either all or substantially all of the risks and rewards of the transferred assets or a portion of them. In such cases, the transferred assets are not derecognised. Examples of such transactions are securities lending and sale and repurchase transactions.

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 Bank retains all or substantially all of the risks and rewards of ownership of such assets.

In transactions in which the Bank neither retains nor transfers substantially all of the risks and rewards of ownership of a financial asset and it retains control over the asset, the Bank continues to recognise the asset to the extent of its continuing involvement, determined by the extent to which it is exposed to changes in the value of the transferred asset.

In certain transactions, the Bank retains the obligation to service the transferred financial asset for a fee. The transferred asset is derecognised if it meets the de-recognition criteria. An asset or liability is recognised for the servicing contract if the servicing fee is more than adequate (asset) or is less than adequate (liability) for performing the servicing.

Financial liabilities

The Bank derecognises a financial liability when its contractual obligations are discharged or cancelled, or expire.

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 de-recognition of the original liability and the recognition of a new liability. The difference between the carrying value of the original financial liability and the consideration paid, including any non-cash assets transferred or liabilities assumed is recognised in profit or loss.

3.9.9 Offsetting

Financial assets and financial liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Bank currently has a legally enforceable right to set off the amounts and it intends either to settle them on a net basis or to realise the asset and settle the liability simultaneously.

3.9.10 Identification, Measurement and Assessment of Impairment of Financial Assets

At each reporting date, the Bank assesses whether there is objective evidence that financial assets not carried at fair value through profit or loss are impaired. 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 are impaired includes:

- significant financial difficulty of the borrower or issuer;
- default or delinquency by a borrower;
- the restructuring of a loan or advance by the Bank on terms that the Bank would not consider otherwise;
- indications that a borrower or issuer will enter bankruptcy;
- the disappearance of an active market for a security; or
- observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the Bank, or economic conditions that correlate with defaults in the group.

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

Impairment of financial assets carried at amortised cost

The Bank considers evidence of impairment for loans and advances and held-to-maturity investment securities at both a specific asset and a collective level. All individually significant loans and advances and held-to-maturity investment securities are assessed for specific impairment. Those found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Loans and advances and held-to-maturity investment securities that are not individually significant are collectively assessed for impairment by grouping together loans and advances and held-to-maturity investment securities with similar risk characteristics

In assessing collective impairment, the Bank uses statistical modelling of historical trends of the probability of default, the timing of recoveries and the amount of loss incurred, and makes an adjustment if current economic and credit conditions are such that the actual losses are likely to be greater or lesser than is suggested by historical trends. Default rates, loss rates and the expected timing of future recoveries are regularly benchmarked against actual outcomes to ensure that they remain appropriate.

Impairment losses on assets measured at amortised cost are calculated as the difference between the carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate.

If the terms of a financial asset are renegotiated or modified or an existing financial asset is replaced with a new one due to financial difficulties of the borrower, then an assessment is made of whether the financial asset should be derecognised. If the cash flows of the renegotiated asset 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 the new financial asset is recognised at fair value. The impairment loss before an expected restructuring is measured as follows.

- If the expected restructuring will not result in de-recognition of the existing asset, then the estimated cash flows arising from the modified financial asset are included in the measurement of the existing asset based on their expected timing and amounts discounted at the original effective interest rate of the existing financial asset.

- If the expected restructuring will result in de-recognition of the existing asset, then the expected fair value of the new asset is treated as the final cash flow from the existing financial asset at the time of its de-recognition. This amount is discounted from the expected date of de-recognition to the reporting date using the original effective interest rate of the existing financial asset.

Impairment losses are recognised in profit or loss and reflected in an allowance account against loans and receivables or held-to-maturity investment securities. Interest on the impaired assets continues to be recognised through the unwinding of the discount. If an event occurring after the impairment was recognised causes the amount of impairment loss to decrease, then the decrease in impairment loss is reversed through profit or loss.

Impairment losses on available-for-sale investment securities are recognised by reclassifying the losses accumulated in the fair value reserve in equity to profit or loss. The cumulative loss that is reclassified from equity to profit or loss is the difference between the acquisition cost, net of any principal repayment and amortisation, and the current fair value, less any impairment loss previously recognised in profit or loss. Changes in impairment attributable to application of the effective interest method are reflected as a component of interest income.

If, in a subsequent period, the fair value of an impaired available-for-sale debt security increases and the increase can be related objectively to an event occurring after the impairment loss was recognised, then

the impairment loss is reversed through profit or loss; otherwise, any increase in fair value is recognised through Other Comprehensive Income. Any subsequent recovery in the fair value of an impaired available-for-sale equity security is always recognised in Other Comprehensive Income.
The Bank writes off certain loans and advances and investment securities when they are determined to be uncollectible.

3.9.11 Collateral Valuation

The Bank seeks to use collateral, where possible, to mitigate its risks on financial assets. The collateral comes in various forms such as cash, securities, letters of credit/guarantees, real estate, receivables, inventories, other non-financial assets and credit enhancements such as netting arrangements. The fair value of collateral is generally assessed, at a minimum, at inception and based on the Bank's annual reporting schedule.

Non-financial collateral such as real estate is valued by an external, independent valuer, having appropriate recognised professional qualifications and recent experience in the location and category of property being valued.

3.9.12 Rescheduled Loans

Loans whose original terms have been modified including those subject to forbearance strategies are considered rescheduled loans. If the renegotiations are on terms that are not consistent with those readily available on the market, this provides objective evidence of impairment. Once terms have been renegotiated, any impairment is measured using the original effective interest rate as calculated before the modification of terms and the loan/ advance is no longer considered past due. Management continually reviews renegotiated loans and advances to ensure that all criteria are met and the future payments are likely to occur.

3.10 Derivative Financial Instruments

Derivatives are financial instruments that derive their value in response to changes in interest rates, financial instrument prices, commodity prices, foreign exchange rates, credit risk and indices. Derivatives are categorized as trading unless they are designated as hedging instruments. Bank uses derivatives such as forward exchange contracts and swaps. Bank has not designated any derivatives as hedging instruments and has not followed hedge accounting as at the reporting date.

All derivatives are initially recognised and subsequently measured at fair value, with all revaluation gains or losses recognised in profit and loss. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative. Fair value is determined using the forward market rates ruling on the reporting date.

3.11 Repurchase and reverse repurchase agreements

Securities sold subject to repurchase agreements (repos) remain on the Statement of Financial Position; the counterparty liability is included under borrowings. Securities purchased under agreements to resell (reverse repos) are recorded as loans and advances to other banks or customers, as appropriate.

3.12 Finance Leases

Assets leased to customers which transfer substantially all the risks and rewards associated with ownership other than legal title, are classified as finance leases. Leasing balances are stated in the Statement of Financial Position after deduction of unearned lease income and the impairment for rentals doubtful of recovery. Amounts receivable under finance leases are classified as Lease Receivables and presented within loans and receivables to other customers in the Statement of Financial Position.

3.13 Property, Plant and Equipment

Property, plant and equipment are tangible items that are held for use in the production or supply of goods or services, for rental to others or for administrative purposes and are expected to be used during more than one period.

3.13.1 Basis of Recognition

Property, plant and equipment are recognised if it is probable that future economic benefits associated with the assets will flow to the Bank and cost of the asset can be reliably measured.

3.13.2 Measurement

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

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

3.13.3 Cost Model

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

3.13.4 Revaluation Model

The Bank applies the revaluation model to the entire class of freehold land and buildings. Such properties are carried at a revalued amount, being their fair value at the date of revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Freehold land and buildings of the Bank are revalued every three years on a roll over basis to ensure that the carrying amounts do not differ materially from the fair values at the reporting date. On revaluation of an asset, any increase in the carrying amount is recognised in Other Comprehensive Income and accumulated in equity, under capital reserve or used to reverse a previous revaluation decrease relating to the same asset, which was charged to profit or loss. In this circumstance, the increase is recognised as income to the extent of the previous write down. Any decrease in the carrying amount is recognised as an expense in the Income Statement or debited in the Other Comprehensive Income to the extent of any credit balance existing in the capital reserve in respect of that asset. The decrease recognised in Other Comprehensive Income reduces the amount accumulated in equity under capital reserves. Any balance remaining in the revaluation reserve in respect of an asset is transferred directly to Retained Earnings on retirement or disposal of the asset.

3.13.5 Subsequent Costs

The subsequent cost of replacing a component of an item of property, plant and equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within that part will flow to the Bank and its cost can be reliably measured. The costs of day to day servicing of property, plant and equipment are charged to profit or loss as incurred. Costs incurred in using or redeploying an item is not included under carrying amount of an item.

3.13.6 De-recognition

The carrying amount of an item of property, plant and equipment is derecognised on disposal or when no future economic benefits are expected from its use or disposal. The gain or loss arising from the de-recognition of an item of property, plant and equipment which is calculated as the difference between the carrying amount and the net disposal proceeds is included in profit or loss when the item is derecognised.

3.13.7 Depreciation

The Bank provides depreciation from the month the assets are available for use while no depreciation is charged in the month in which the assets are disposed-off at the following rates on a straight line basis over the periods appropriate to the estimated useful lives based on the pattern in which the asset's future economic benefits are expected to be consumed by the Bank. Depreciation of an asset ceases at the earlier of the date that the asset is classified as held for sale or the date that the asset is derecognised. Leased assets are depreciated over the shorter of the lease term and their useful lives unless it is reasonably certain that the Bank will obtain ownership by the end of the lease term

The estimated useful lives are as follows:

<u>Straight-Line Basis</u>	
Freehold building	40 years at 2.5% per annum
Leasehold Properties	3 years at 33.33% per annum
Computer Hardware and Software	4 years at 25% per annum
Office Equipment	10 years at 10% per annum
Furniture & Fittings	10 years at 10% per annum
Motor Vehicles	20% per annum (subject to 20% residual value)

3.14 Intangible asset

An intangible asset is an identifiable non-monetary asset without physical substance held for use in the production or supply of goods or services, for rental to others or for administrative purposes.

3.14.1 Basis of Recognition

An intangible asset is recognised if it is probable that the future economic benefits that are attributable to the asset will flow to the entity and the cost of the assets can be measured reliably. An intangible asset is initially measured at cost. The cost of intangible assets acquired in a business combination is the fair value as at the date of acquisition.

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

Software

All computer software costs incurred, licensed for use by the Bank, which are not integrally related to associated hardware, which can be clearly identified, reliably measured and it's probable that they will lead to future economic benefits, are included in the Statement of Financial Position under the category Intangible Assets and carried at cost less accumulated amortisation and any accumulated impairment losses.

3.14.2 Subsequent Expenditure

Expenditure incurred on software is capitalised only when it is probable that this expenditure will enable the asset to generate future economic benefits in excess of its originally assessed standard of performance and this expenditure can be measured and attributed to the asset reliably. All other expenditure is expensed as incurred.

3.14.3 Amortisation

Intangible assets are amortised on a straight line basis in profit or loss from the date when the asset is available for use, over the best estimate of its useful economic life based on a pattern in which the asset's economic benefits are consumed by the Bank. The estimated useful life of software is three years. Amortisation methods, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate.

3.15 Impairment of Non–Financial Assets

At each reporting date, the Bank reviews the carrying amounts of its non-financial assets (other than 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.

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.

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.

3.16 Employee benefits
3.16.1 Defined benefit pension plan

A defined benefit plan is a post-employment benefit plan other than a defined contribution plan. The liability recognised in the statement of financial position in respect of the defined benefit plan is the present value of defined benefit obligation as at the reporting date. The defined benefit obligation is calculated annually by independent actuaries using Projected Unit Credit Method (PUC) as recommended by LKAS 19 - "Employees Benefits".

The assumptions based on which the results of the valuation were determined are included in the note 28 to the Financial Statements.

The liability is not externally funded.
The Bank recognizes all actuarial gains and losses arising from defined benefit plan in Other Comprehensive Income and expenses related to defined benefit plans in staff expenses in profit or loss.

Provision has been made for retirement gratuities from the first year of service for all employees in conformity with the LKAS 19. However under the payment of Gratuity Act No. 12 of 1983, the liability to an employee arises only on completion of 5 years of continued service.

3.16.2 Defined contribution Plan
Employees' provident fund

All employees of the Bank are members of the MCB Bank Limited Sri Lanka Branch Staff Provident Fund to which the Bank and employees contributes 12% and 8% of such employees' basic salary and allowances respectively.
Employees' Trust Fund
The Bank contributes 3% of the salary of each employee to the Employees' Trust Fund.

3.17 Deposits from Customers

Deposits from customers include non-interest bearing deposits, saving deposits, term deposits, and deposits payable at call and certificate of deposits. They are stated in the Statement of Financial Position at amounts payable. Interest paid/payable on these deposits is charged to profit or loss.

3.18 Borrowings

Borrowings include refinance borrowings, call money bowings, and borrowings from financial institutions and are shown at the gross value of the outstanding balance. Interest paid/payable on these deposits is charged to profit or loss.

3.19 Provisions

A provision is recognised if, as a result of a past event, the Bank has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. The amount recognised is the best estimate of the consideration required to settle the present obligation at the reporting date, taking in to account the risks and uncertainties surrounding the obligation at that date. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is determined based on the present value of those cash flows.

3.20 Capital commitments and contingencies

Contingent liabilities are possible obligations whose existence will be confirmed only by occurrence or non-occurrence uncertain future events not wholly within the control of the Bank or present obligations where the transfer of economic benefit is not probable or cannot be reliably measured. Contingent liabilities are not accounted in the Statement of Financial Position but are disclosed unless they are remote.

'Financial guarantees' are contracts that require the Bank 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.

3.21 Cash Flow Statement

The Cash Flow Statement has been prepared using the "Direct Method" of preparing Cash Flows in accordance with the Sri Lanka Accounting Standard 07-Statement of Cash Flows.

3.22 Regulatory Provisions

Deposit Insurance Scheme

In terms of the Banking Act Direction No 5 of 2010 "Insurance of Deposit Liabilities" issued on 27th September 2010 and subsequent amendments there to all Licensed Commercial Banks are required to insure their deposit liabilities in the Deposit Insurance Scheme operated by the Monetary Board in terms of Sri Lanka Deposit Insurance Scheme Regulations No 1 of 2010 issued under Sections 32A to 32E of the Monetary Law Act with effect from 1st October 2010. The said scheme was renamed as the "Sri Lanka Deposit Insurance and Liquidity Support Scheme" as per the Sri Lanka Deposit Insurance and Liquidity Support Scheme Regulation No 1 of 2013. Deposits to be insured include demand, time and savings deposit liabilities and exclude the following;

- deposit liabilities to member institutions
- deposit liabilities to Government of Sri Lanka
- deposit liabilities to Directors, key management personnel and other related parties as defined in Banking Act Direction No 11 of 2007 on Corporate Governance of Licensed Commercial Banks
- deposit liabilities held as collateral against any accommodation granted deposit liabilities falling within the meaning of abandoned property in terms of the Banking Act and dormant deposits in terms of the Finance Companies Act funds of which have been transferred to Central Bank of Sri Lanka

Licensed Commercial Banks are required to pay a premium of 0.10% on eligible deposit liabilities if the Bank maintains a capital adequacy ratio of 14% or above as at the end of the immediately preceding financial year and a premium of 0.125% on eligible deposit liabilities for all other Licensed Commercial Banks calculated on the total amount of eligible deposits as at the end of the quarter within a period of 15 days from the end of the quarter.

4. Events occurring after the Reporting Date

All material events after the reporting date have been considered and where appropriate adjustments or disclosures have been made in the respective Notes to the Financial Statements.

4.1 Comparative Information

The comparative information is re- classified wherever necessary to confirm with the current year's classification in order to provide a better presentation.

5. New Accounting Standards issued but not yet effective as at Reporting date

The Institute of Chartered Accountants of Sri Lanka has issued the following new Sri Lanka Accounting Standards. However these standards have not been applied in preparing these financial statements.

Accounting standard	Summary of the requirements	Possible impact on Financial Statements
SLFRS 9 – "Financial Instruments"	SLFRS 9 – "Financial Instruments" SLFRS 9, issued in 2014 which replaces the existing guidance in LKAS 39 – "Financial Instruments: Recognition and Measurement" is effective for annual	The most significant impact on the Bank's financial statements from the implementation of SLFRS 9 is expected to result from the new impairment requirements. Impairment losses

reporting periods beginning on or after January 1, 2018. The key aspects of SLFRS 9 are;

1. Classification – Financial assets

SLFRS 9 contains a new classification and measurement approach for financial assets that reflects the business model in which assets are managed and their cash flow characteristics. SLFRS 9 includes three principal classification categories for financial assets – i.e. measured at amortised cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL). It eliminates the existing LKAS 39 categories of Held to maturity, Loans and receivables and Available for sale.

2. Impairment – Financial assets, loan commitments and financial guarantee contracts

SLFRS 9 replaces the "Incurred Loss Model" in LKAS 39 with forward looking "Expected Loss Model" (ECL). This will require considerable judgement over how changes in economic factors affect ECL, which will be determined on a probability weighted basis.

SLFRS 9 requires loan loss to be recognised at an amount equal to either 12 month ECL or life time ECL. Lifetime ECLs are the ECLs that result from possible default events over the expected life of a financial instrument, whereas 12 months ECLs are the portion of the ECLs that results from default events that are possible within 12 months after the Reporting date.

3. Inputs into measurement of ECLs

The key inputs into measurement of ECLs are likely to be the term structures of the following variables which will be derived from internally developed statistical models and other historical data that leverage regulatory models.

will increase and become more volatile for financial instruments within the scope of SLFRS 9.

The Bank has employed statistical models to analyse the data collected and generate estimates of the remaining lifetime PD of exposure and how these are expected to change as a result of the passage of time. This analysis includes the identification and calibration of relationship between changes in default rates and changes in key macro-economic factors as well as analysis of the impact of certain other factors on the risk of default.

Since the Bank does not have enough history to establish LGD, Collaterals allocated for the loans are analysed and LGD is determined respectively for cash backed securities, lending done on clean basis and other loan with non-cash backed securities.

EAD for lending commitments and financial guarantees, include the amount drawn, as well as potential future amounts that may be drawn or repaid under the contract, which has been estimated based on historical observations and forward looking forecasts.

Under SLFRS 9, the Bank has incorporated forward looking information into both its assessment of whether the credit risk of an instrument has increased significantly since its initial recognition and its measurement of ECL.

The Bank has completed the initial high level assessment of the potential impact on its Financial Statements for the year ended December 31, 2016, resulting from the application of

	They will be adjusted to reflect forward looking information. Probability of Default (PD) are estimates at a certain date which will be calculated based on statistical models and assessed using rating tools tailored to the various categories of counterparties and exposures. Loss Given Default (LGD) is the magnitude to the likely loss if there is default. The Bank estimates LGD parameters based on history of recovery rates of claims against defaulted counter parties. Exposure at Default (EAD) represents the expected exposure in the event of a default. The Bank will derive the EAD from the current exposure to the counterparty and potential chances to the current amount allowed under the contract. The most significant impact on the Bank's financial statements from the implementation of SLFRS 9 is expected to result from the new impairment requirements. Impairment losses will increase and become more volatile for financial instruments within the scope of SLFRS 9.	SLFRS 9 with the assistance of an external consultant. Based on the preliminary assessments undertaken to date which is yet to be audited, the total estimated additional loan loss provision on the Financial Statements for the year ended December 31, 2016 on adoption of SLFRS 9 is expected to be in the range of 15% to 20% of the total impairment provision as per the current LKAS 39. It will also have an impact on Tier 1 Capital Adequacy Ratio of approximately 33 **bps** The above assessment is preliminary (and is yet to be audited) because not all transition work has been finalised. The actual impact of adopting SLFRS 9 on January 1, 2018 may change because; • SLFRS 9 will require the Bank to revise accounting process and internal controls and these changes are not yet complete; • The Bank is refining and finalising its models for ECL calculations; and • The new accounting policies, assumptions, judgements and estimation techniques employed are subject to change until the Bank finalises its first financial statements for the year December 31, 2018 that include the date of initial application. The Bank is in the process of assessing the additional loan loss provision impact on the Financial Statements for the year ended December 31, 2017, resulting from the application of SLFRS 9. The Bank is expected to maintain solid capital position even after

		taking into account the first time adoption of SLFRS 9, effective from January 1, 2018
SLFRS 15 – "Revenue from Contracts with Customers"	SLFRS 15 establishes a comprehensive framework for determining whether, how much, and when revenue is recognised. New qualitative and quantitative disclosure requirements aim to enable Financial Statements users to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. Entities will apply five-step model to determine when to recognize revenue and at what amount. The model specified that revenue is recognised when or as an entity transfers control of goods and services to a customer at the amount to which the entity expects to be entitled.	Bank do not expect significant impact on its Financial Statements resulting from the application of SLFRS 15.
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.	Bank do not expect significant impact on its Financial Statements resulting from the application of SLFRS 16.

6. Financial Risk Management

6.1 Introduction and Overview

The Bank has exposure to the following risks from financial instruments:

- Credit Risk
- Market Risk
- Liquidity Risk
- Operational Risk

6.2 Risk Management Framework

The Bank executes its risk strategy and undertakes controlled risk-taking activities within its risk management framework. This framework combines core policies, procedures and process design with broad oversight and is supported by risk monitoring across the Bank. This framework is based on prudent risk identification, measurement, management and monitoring process which are closely aligned with the activities of the Bank so as to ensure that risks are kept within an acceptable level.

The Bank, at local level has its Risk Management structure in place to monitor the Bank wide risk. For this purpose the Bank has constituted the following Committees:

- Asset and Liability Management Committee (ALCO) which monitors the Asset Liability Structure and management of market risk of the Bank.
- Credit Committee (CC) which monitors the credit risk of the Bank.
- Integrated Risk Management Committee (IRMC) which monitors the overall risk of the Bank.

These committees are established to assist the Board of Directors, its relevant committees and senior management at head office, i.e. head office ALCO, Risk Management and Portfolio Review Committee (RM and PRC), Management Committee (MC), Management Committee of Risk who are responsible to ensure the formulation and implementation of a comprehensive risk management framework.

The risk management function in Sri Lanka is headed by a designated Chief Risk Officer (CRO) reporting functionally to the Group Head Risk Management, who in turn reports to Risk Management and Portfolio Review Committee of the Board, and administratively to the Country General Manager. The role of the CRO is both as a strategic partner to the business units advising them on risk issues and on the best ways to identify and manage these risks.
The CRO performs following critical functions:

- Integrated risk management
- Credit risk management
- Market and liquidity risk management
- Operational risk management

6.3 Credit Risk

Credit risk arises from dealings with individuals, corporate borrowers, financial institutions, sovereigns etc. The Bank is exposed to credit risk through its lending and investment activities. It also stems from both on and off- Balance Sheet activities. Credit risk makes up the largest part of the Bank's exposure. The Purpose of the credit risk function is to identify measure, manage, monitor and mitigate credit risk. Organizational structure of this function ensures pre and post-facto management of credit risk. There is a clear segregation of duties between transaction originators, credit administration and the risk function.

The credit risk management framework of the Bank encompasses the following:

- Reviewing the credit policies and procedures in line with the risk management policy and international best practices;

- Use of comprehensive credit appraisal process structured towards analyzing pertinent information at macro and micro levels.

- Delegated approval/ review authority assigned to officers/ executives with the necessary experience, judgment and integrity to properly evaluate the risks and rewards involved in the credit transactions.

- A hindsight review process to ensure the checks and balances has been instituted to ensure consistent application of the Bank's credit policies.

- Monitoring of credits with deteriorating credit ratings and inclusion of those advances on a watch-list that is regularly reviewed by senior management.

- Centralized credit administration unit to support the extension and monitoring of credit by the business units.

- Segregation of duties by independent units to carryout Credit approval, Risk Management, Credit administration, Credit review functions.

- Measurement and monitoring of credit risk at the counterparty level by using internal risk rating models.

- Development and adaptation of risk measurement techniques/models to suit the regulatory and industry requirements.

- Centralized Credit Administration unit to manage Problem credits and Non Performing Advances. This unit is responsible for all aspects of an overdue facility, follow up of rescheduled facilities, monitoring the value of the applicable collateral and liquidation, scrutiny of legal documents and liaising with the customer until all recovery matters are finalized.

6.3.1 Impairment Assessment

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

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

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

6.3.2 Collectively Assessed Allowances

Allowances are assessed collectively for losses on loans and advances and for held to maturity debt investments that are not individually significant and for individually significant loans and advances that have been assessed individually and found not to be impaired.
The Bank generally bases its analyses on historical experience. However, when there are significant market developments, the Bank would include macro-economic factors within its assessments. These factors include, depending on the characteristics of the individual or collective assessment unemployment rates, current levels of bad debts, changes in laws, changes in regulations, bankruptcy trends, and other consumer data. The Bank may use the aforementioned factors as appropriate to adjust the impairment allowances. Allowances are evaluated separately at each reporting date with each portfolio.

The collective assessment is made for groups of assets with similar risk characteristics, in order to determine whether provision should be made due to incurred loss events for which there is objective evidence, but the effects of which are not yet evident in the individual loans assessments. The collective assessment takes account of data from the loan portfolio or economic data. The approximate delay between the time a loss is likely to have been incurred and the time it will be identified as requiring an individually assessed impairment allowance is also taken into consideration. The management is responsible for deciding the length of this period, which can extend for as long as one year. The impairment allowance is then reviewed by credit management to ensure alignment with the Bank's overall policy.

The Bank also conducts stress testing of its portfolio, which includes all assets, i.e., advances as well as investments. This exercise is conducted on a quarterly basis through assigning shocks to all assets of the Bank and assessing its resulting effect on capital adequacy in line with Central Bank of Sri Lanka (CBSL) requirements.

6.3.3 Concentration of Credit Risk

In order to mitigate the credit risk, MCB regularly reviews its portfolio concentration across the various industrial sectors. Sector wise credit exposures are provided in the Note 18 to the financial statements.

6.3.4 Fair Value of Collateral held Against Loans and Advances to Customers

Bank seeks to use collateral, where possible to mitigate its risk on financial assets. The collateral comes in various forms such as cash, securities, letter of credits, /guarantees, real estate, receivables, inventories, other non-financial assets and credit enhancements such as netting arrangements. The fair value of collaterals is generally assessed, at a minimum, at inception and based on the bank's annual reporting schedules.

As at 31 December 2017	Gross Loans & Advances	Fair Value of Security
	Rs 000	Rs 000
Against Individually Impaired		
Immovable Property	811,944	1,068,650
Deposits	55,357	15,800
Others	126,116	-
Unsecured (Covered with loan agreement)	72,415	-
Total against individually impaired (A)	1,065,832	1,068,650
Against Collectively Impaired		
Immovable Property	1,318,063	1,704,600
Deposits	7,848,640	6,867,082
Others	7,038,294	
Unsecured (Covered with loan agreement)	2,307,352	
Total against collectively impaired (B)	18,512,349	
Total (A+B)		
Leases	134,209	150,000
Grand Total	20,668,741	

An updated valuation of collateral is generally not carried out unless the credit risk of a loan deteriorates significantly and the loan is monitored more closely. For impaired loans, the bank usually obtains appraisals of collateral as the current value of the collateral may be an input to the impairment measurement.

Others include loans secured by movable equipment and machinery, vehicle mortgages, inventory and book debts, shares, demand promissory notes / personal guarantees, corporate guarantees, trust certificates, negative pledge/ agreement to mortgage / undertaking to mortgage, insurance policy and power of attorney.

6.4 Market Risk

Market Risk is the risk of financial losses resulting from unfavorable changes in underlying market factors, including interest rates, foreign exchange rates, equity prices, commodity prices and market volatility.

Middle office monitors the treasury operating limits, including; open position limits, dealer limits, counter party limits, etc., which are regularly reviewed and updated as per the prevailing business requirements, and regulatory guidelines.

The Bank measures and manages market risk by using conventional methods i.e. notional amounts, sensitivity and combinations of various limits. The Bank also uses VaR (Value at Risk) technique for market risk assessment of positions assumed by its treasury. In-house and vendor based solutions are used for calculating mark to market value of positions and generating VaR (value at risk) and PVBP (Price Value of a Basis Point) numbers.

Foreign exchange risk exposes the Bank to changes in the values of current holdings and future cash flows denominated in currencies other than the home currency due to the exchange rate fluctuation and volatility. The core objective of foreign exchange risk management is to ensure that the foreign exchange exposure of the Bank remains within defined risk parameters and insulates the Bank against undue losses that may arise due to volatile movements in foreign exchange rates or interest rates.

Limit structure to manage foreign exchange risk is in place. Net open position and gap limits on different tenors in major currencies are established and monitored on a regular basis. Stress testing of foreign exchange portfolio as per CBSL requirements is a regular feature of the foreign exchange risk management.

Following table shows the assets which are exposed to market risk in the banking book.

	2017		
	Carrying Amount	Trading Portfolios	Non Trading Portfolios
	Rs 000	Rs 000	Rs 000
Assets subject to Market Risk			
Trading Assets	-	-	-
Derivative Financial Instruments	1,504	-	1,504
Loans & advances to Customers	20,238,967	-	20,238,967
Financial Instruments –Available for sale	3,251,974	-	3,251,974
Financial Investments – Held to Maturity	1,746,096	-	1,746,096
Liabilities subject to market risk			
Derivative Financial Instruments	87,164	-	87,164
Deposits from customers	18,670,300	-	18,670,300
Borrowings	3,337,143	-	3,337,143
Other Borrowings	99,175	-	99,175

6.4.1 Interest Rate Sensitivity on interest bearing assets and liabilities

The table below depicts the interest rate sensitivity based on the interest rate sensitive positions as at 31st December 2017. In its cumulative position up to 12 month time bucket, Bank carries an asset sensitive position. This asset sensitive position will vary for each time bucket up to 12 months period in which during the time bucket of over 1 – up to 3 months, the Bank would experience assets sensitive position of LKR 2.24Mn. The interest rate sensitivity of the Bank indicates that in case of an interest rate decline, the Bank would tend to experience a loss of LKR 46.99Mn in its Net Interest Income (NII) while in case of interest rate increase the Bank would enhance its Net interest income by LKR 46.99Mn. This interest rate risk exposure is quantified based on the assumed change in the interest rates for each time period given in the table shown below.

Parameter	0 to 1 Month	Over 1- up to 3 Months	Over 3- up to 6 Months	Over 6 – up to 12 Months
	Rs.000'	Rs.000'	Rs.000'	Rs.000'
Total interest bearing assets	12,894,327	4,305,562	5,905,838	528,702
Total interest bearing liabilities	7,684,074	6,545,771	2,904,185	1,801,173
Net interest bearing assets (liabilities)	5,210,253	(2,240,209)	3,001,653	(1,272,471)
Cumulative Gap	5,210,253	2,970,044	5,971,697	4,699,226
Assumed change in interest rates	1%	1%	1%	1%
Impact	52,103	(22,402)	30,017	(12,725)
Net impact on NII if interest rates increase				46,992
Net impact on NII if interest rates decline				(46,992)

6.4.2 Foreign exchange position as of 31 December 2017

Currency	Spot Net	Forward Net	Net Open Position	Overall position in LKR
AUD	(2,528)		(2,528)	(302,900)
EUR	(328)		(328)	(60,230)
GBP	665		665	137,686
HKD	(4,730)		(4,730)	(93,034)
JPY	(441,450)		(441,450)	(601,873)
CNY	(4,353)		(4,353)	(102,678)
SGD	(1,223)		(1,223)	(140,677)
USD	(115,508)	(389)	(115,897)	(17,819,121)
Total Exposure				(18,982,826)

Total capital funds as per the latest Audited Financial Statements (Capital base as at 31st December 2017)	5,252,316,037
Total exposure as a % of total capital funds as per the latest audited financial	0.36%

6.4.3 Forex Risk in Net Open Position (NOP)

The table indicates the exchange rate risk exposure based on its net open position to deferent currencies. As of 31st December 2017, bank carried USD net open "Short" position. The bank will be exposed to exchange rate risk in case, LKR appreciates against USD. The sensitivity analysis on this exposure at deferent shock level is presented below.

A sensitivity analysis of foreign currency net open position was carried out applying shock level increase of 1%, 3% and 5% level on the current exchange rate and the impact on USD equivalent NOP and the impact on income statement is as follows.

Sensitivity Analysis for the Exchange Rate Risk Exposure as at 31st December 2017

Position as at 31st December 2017	Amount
Net exposure – USD	123,077
Overall exposure in LKR	18,982,826
Exchange rate (USD/LKR)	153.75

Effect on income statement (LKR)	
If Exchange rate appreciates by 1%	189,828
If Exchange rates appreciates by 3%	569,485
If exchange rate appreciates by 5%	949,141

6.5 Liquidity Risk

To manage the liquidity, which represents the Bank's ability to fund assets and meet obligations as they become due, the Bank's asset-liability mismatches are monitored by preparing the asset liability statements on a regular basis enabling the senior management to take appropriate measures.

ALCO, headed by the Country General Manager, monitors and manages the Bank's overall assets and liabilities structure through constant monitoring, and implementing corrective actions through various banking products and mechanisms such as the management of advances, deposits and investment portfolios.

A net liquidity asset to deposits from customers is depicted below.

	2017 %	2016 %
Net liquid assets to deposits from customers		
At 31 December	30.38%	34.55%
Average for the year	34.20%	45.11%
Maximum for the year	42.65%	77.76%
Minimum for the year	30.38%	34.55%

The Bank monitors the following liquidity ratios to assess funding requirements

	2017	2016
Advances to Deposit Ratio		
Average for the Year ended	117.44%	123.45%
Minimum for the Year ended	110.86%	116.49%
Maximum for the Year ended	125.00%	142.38%
As at	110.90%	110.48%
Statutory Liquid Asset Ratio		
Average for the Year ended	27.75%	30.91%
Minimum for the Year ended	24.27%	24.82%
Maximum for the Year ended	36.85%	45.78%
As at	25.02%	26.73%

Liquid assets include Cash and Short term Funds, Bills purchased and short term Investments. Liabilities to external stake holders include deposits, borrowing and other liabilities.

To manage the Liquidity Risk arising from Financial Liabilities, the Bank holds liquid assets comprising Cash and Cash Equivalents and Government treasury bills for which there is an active and liquid market. These assets can be readily sold to meet liquidity requirements.

Banks are required to comply with the provisions of the Basel III framework with a view to promote the short-term resilience of a bank's liquidity risk profile through the introduction of the Liquidity Coverage Ratio (LCR) of 80% as of 31st December 2017.

As of 31st December 2017, Bank reported all currency LCR ratio of 169.63% which remain comfortably above the CBSL's requirements.

6.6 Operational Risk

Operational Risk is the risk of a loss resulting from an inadequacy or a failure ascribable to people, processes, technology or external events. Currently the Bank is reporting operational risk capital charge under Basic Indicator Approach (BIA).

The Bank's objective is to manage operational risk so as to balance the avoidance of financial losses and damage to the Bank's reputation with overall cost effectiveness and to avoid control procedures that restrict initiative and creativity.

The primary responsibility for the development and implementation of controls to address operational risk is assigned to senior management within each business unit. This responsibility is supported by the development of overall Bank's standards for the management of operational risk in the following areas:

- requirements for appropriate segregation of duties, including the independent authorization of transactions
- requirements for the reconciliation and monitoring of the transaction
- compliance with regulatory and other legal requirements
- documentation of controls and procedures

- requirements for the periodic assessment of operational risk faced, and the adequacy of controls and procedures to address the risks identified
- requirements for the reporting of operational losses and proposed remedial action
- development of contingency plans
- training and professional development
- ethical and business standard, and
- risk mitigation, including insurance where this is effective.

Compliance with Bank's standards is supported by a program of periodic reviews undertaken by Internal Audit.

The results of Internal Audit reviews are discussed with the management of the business unit to which they relate, with summaries submitted to the senior management of the Bank.

6.7 Capital Management

The main objectives of managing banks' capital are as follows:

- maintain sufficient capital to meet minimum regulatory capital requirement.
- hold sufficient capital to support banks risk appetite
- allocate capital to business to support the bank's strategic objectives.

6.7.1 Statutory minimum capital requirement and capital management

As required by the circular issued by Central Bank of Sri Lanka on "Enhancement of Minimum Capital Requirement of Banks" the Bank was required to increase its capital as follows in the interest of a strong and sound banking system.

(a) Rs.3 Billion by 31st December 2011
(b) Rs.4 Billion by 31st December 2013
(c) Rs.5 Billion by 31st December 2015

The Bank achieved the target Core Capital of Rs.3 Bn. by 31st December 2011, Rs.4 Bn. by 31st December 2013 and Rs.5 Bn by 31st December 2015.

6.7.2 Regulatory Capital

The Bank manages its capital considering regulatory capital requirements. The Central Bank of Sri Lanka (CBSL) sets and monitors capital requirements for licensed banks in Sri Lanka based on the Basel Framework. Thus the Bank's operations are directly supervised by the CBSL and the Bank is required to comply with the Provisions of the Basel II framework in respect of regulatory capital. Commercial banks in Sri Lanka need to maintain a Total Capital Adequacy Ratio (CAR) of 10% and a Core Tier 1 Capital Ratio of at least 5%. Basel III framework in respect of regulatory capital states that Commercial banks in Sri Lanka with Asset less than Rs.500 Billion, need to maintain a Common Equity Tier 1 capital (CET1) including capital conversation buffer of 5.75%, Total Tier 1 Including capital conservation buffer of 7.25% and Total capital ratio of 11..25%.(As of 31st December 2017)

The Bank computes CAR as a ratio of its capital to its risk weighted assets. Calculations of the risk weightings defined under credit risk and market risk are based on the standardized approach whereas operational risk is computed by using the basic indicator approach.

As of 31st December 2017, Bank reported a Common Equity Tier 1 capital (CET1) including capital conservation buffer of 35.12%, Total Tier 1 including capital conservation buffer of 35.12% and Total Capital Ratio of 31.34%.which remain comfortably above the CBSL's capital requirements.

Item	Amount 'Rs.000
Common Equity Tier 1 Capital	5,885,371
Total Tier 1 Capital	5,885,371
Total Capital	5,252,316
Total Risk Weighted Amount	16,758,952
Risk Weighted Amount for Credit Risk	15,105,172
Risk Weighted Amount for Market Risk	21,272
Risk Weighted Amount for Operational Risk	1,632,508
Common Equity Tier 1 Capital Ratio	35.12
Total Tier 1 Capital Ratio	35.12
Total Capital Ratio	31.34

For the year ended 31st December, All amounts in Sri Lankan Rupees	2017	2016
7. Net Interest Income		
Interest Income		
Placement with banks	73,645,361	51,324,681
Loans and advances to customers	2,063,687,627	1,421,978,144
Financial investments - Held to maturity	87,820,802	109,765,768
Financial investments - Available-for-sale (Note 7.a)	386,576,146	285,276,738
Total Interest Income	2,611,729,936	1,868,345,331
Interest Expenses		
Banks and other borrowings	82,702,097	96,084,056
Deposits from Customers	1,122,742,010	654,547,733
Securities sold under repurchase agreements (Note 7.a)	11,175,628	8,559,512
Total Interest Expenses	1,216,619,735	759,191,301
Net Interest Income	1,395,110,201	1,109,154,030

7.a Net Interest Income from Sri Lanka Government Securities

Interest Income	386,576,146	285,276,738
Interest Expenses	11,175,628	8,559,512
	375,400,518	276,717,226

According to section 137 of the Inland Revenue Act No. 10 of 2006, a company which derives interest income from secondary market transactions in Government securities is entitled to a notional tax credit (being the one ninth of the net interest income) provided such interest income forms a part of the statutory income of the company for that year of assessment.

Accordingly, net interest income earned from secondary market transactions in Government securities for the year by the bank has been grossed up in the financial statements and resulting notional tax credit amounted to Rs. 31.451 Mn (2016 : Rs. 20.76 Mn)

8. Net Fee and Commission Income

	2017	2016
Fee and commission income (Note 8.1)	126,357,870	119,140,738
Net fee and commission income	126,357,870	119,140,738

8.1 Comprising;

	2017	2016
Loans	1,389,593	1,318,934
Trade and remittances	101,982,612	92,153,294
Deposits	2,935,101	2,364,584
Guarantees	20,050,564	23,303,926
Fee and Commission Income	126,357,870	119,140,738

For the year ended 31st December, All amounts in Sri Lankan Rupees	2017	2016
9. Other Operating Income		
Gain on revaluation of foreign exchange	2,954,549	29,732,190
Dividends on Available For Sale equity securities	823,500	382,500
Gain / (Loss) on sale of securities	37,107,820	-
Profit on sale of Property, plant and equipment	117,159	59,980
Charges recovered	30,734,025	27,394,866
Fair value change of derivatives	6,806,459	3,474,958
Bad debt recovered	5,000,000	-
Others	15,474,776	12,239,920
Other Operating Income	99,018,288	73,284,414
10. Impairment Charges for Loans		
Charge from individual impairment (Note 18.c)	149,928,724	40,247,663
Charge from collective impairment (Note 18.c)	(7,276,944)	11,238,941
	142,651,780	51,486,604
11. Personnel expenses		
Salary and Bonus	246,673,353	225,698,570
Contribution to Employees' Provident Fund	15,738,058	14,034,094
Contribution to Employees' Trust Fund	3,754,816	3,365,164
Provision for Defined Benefit Obligations (Note 28.1.a)	14,326,165	12,025,238
Amortization of Prepaid Employee Benefits	2,764,013	4,133,191
	283,256,405	259,256,257
12. Other Expenses		
Auditors' Remuneration - Audit	1,568,000	1,524,900
Auditors' Remuneration - Non Audit	1,233,560	566,000
Professional and Legal Expenses	3,217,776	3,276,574
Depreciation of Property, Plant and Equipment	39,491,361	22,700,508
Amortisation of Intangible Assets	14,464,509	7,154,002
Office Administration and Establishment Expenses	265,397,260	232,052,592
	325,372,466	267,274,576

For the year ended 31st December,
All amounts in Sri Lankan Rupees

13. Income Tax Expense

	2017	2016
13.a Current Tax Expense		
Current tax on profit for the year	209,590,420	174,565,546
Under/(Over) provision for the previous year	(3,926,262)	2,817,373
	205,664,158	177,382,919
Deferred Tax Expenses		
Deferred tax assets recognized/(reversal) during the year (Note 27)	2,858,655	2,863,949
	2,858,655	2,863,949
Total Income Tax Expense	208,522,813	180,246,868
13.b Reconciliation From Profit/(Loss) Before Tax to Current Income Tax Expense		
Accounting profit Before Tax	712,209,398	619,318,451
Exempt Income	(73,717,230)	(90,746,562)
Disallowable Expenses	405,416,423	317,410,340
Allowable Expenses	(295,371,375)	(222,533,850)
Adjusted Profit/(Loss) From Trade	748,537,216	623,448,379
Interest Income Considered Separately	-	-
Total Statutory Income	748,537,216	623,448,379
Less: Tax Losses Set-Off (Up to a Limit of 35% of Total Statutory Income)	-	-
Taxable Profit	748,537,216	623,448,379
Statutory Income Tax Rate	28.00%	28.00%
Current Income Tax Expense	209,590,420	174,565,546

13.c Reconciliation of effective tax rate

For the year ended 31st December	2017 %	2017 Rs.	2016 %	2016 Rs.
Profit before income tax	100.00%	712,209,398	100.00%	619,318,451
Tax using the corporate tax rate	28.00%	199,418,631	28.00%	173,409,166
Disallowable expenses	15.94%	113,516,598	14.35%	88,874,895
Allowable expenses	-11.61%	(82,703,985)	-10.06%	(62,309,478)
Tax exempt income	-2.90%	(20,640,824)	-4.10%	(25,409,037)
Current tax on profits for the year [Note 13 (a)]	29.43%	209,590,420	28.19%	174,565,546
(Over) / under provision in prior years	-0.55%	(3,926,262)	0.45%	2,817,373
Current tax on profits for the year	28.88%	205,664,158	28.64%	177,382,919
Charge to deferred tax liability on temporary differences	0.73%	5,174,259	0.41%	2,547,037
Recognition of deferred tax asset on temporary differences	-0.33%	(2,315,604)	0.05%	316,912
Total income tax expense	29.28%	208,522,813	29.10%	180,246,868

As at 31 December
All amounts in Sri Lankan Rupees

	2017	2016
14. Cash and cash equivalents		
Local currency in hand	195,797,971	201,801,575
Foreign currency in hand	1,673,823	1,673,823
	197,471,794	203,475,398
15. Balances with Central Banks		
Statutory balances with central banks		
Central bank of Sri Lanka	1,251,967,925	1,207,716,570
Non Statutory balances with central banks		
Central bank of Sri Lanka	860,513,873	375,144,230
	2,112,481,798	1,582,860,800

As required by provisions of Section 93 of the Monetary Law Act, a cash balance is maintained with the Central Bank of Sri Lanka as explained in Note 3.9. The minimum cash reserve requirement on Rupee deposit liabilities was 7.5% as at 31 December 2017.

16. Placements with Banks

	2017	2016
Placement with local banks	741,985,780	1,157,723,607
Placement with foreign banks	131,791,451	412,925,002
Total placement with banks	873,777,231	1,570,648,609

17. Derivative Financial Instruments

As at 31 December 2017	Asset	Liability
Currency swaps	1,499,865	87,163,711
Forward foreign exchange contracts	3,777	-
	1,503,642	87,163,711

As at 31 December 2016	Asset	Liability
Currency swaps	8,351,398	339,933
Forward foreign exchange contracts	2,036,073	209,921
	10,387,471	549,854

The Bank's exposure under derivative contracts is closely monitored as part of the overall management of the Bank's market risk.

As at 31 December *All amounts in Sri Lankan Rupees*	2017	2016

18. Loans and advances to customers

	2017	2016
Gross loans and advances (Note 18.a)	20,668,741,355	15,695,187,150
Less: Individual impairment (Note 18.c)	375,472,031	226,932,500
Collective impairment (Note 18.c)	54,159,403	61,417,145
Net loans and advances	20,239,109,921	15,406,837,505

18.a Concentration of Credit Risk

The Bank monitors concentrations of credit risk by product, currency and industry. An analysis of concentrations of Credit Risk from Loans and Advances as at the Reporting Date is shown below.

	2017	2016
Concentration by Product		
Overdrafts	6,080,806,211	5,020,403,828
Trade finance	4,126,477,446	4,190,669,058
Lease rentals receivable (Note 18.b)	134,208,570	133,277,088
Staff loans	104,336,336	103,254,479
Term loans	1,537,137,341	1,110,678,228
Short-term	8,685,775,451	5,136,904,469
	20,668,741,355	15,695,187,150

	2017	2016
Concentration by Currency		
Sri Lankan Rupee	16,016,446,042	13,285,915,058
United States Dollar	4,314,077,554	2,409,272,092
European Euro	338,217,759	-
	20,668,741,355	15,695,187,150

	2017	2016
Concentration by Industry		
Agriculture and fishing	2,087,403,651	2,042,783,946
Manufacturing	1,504,102,897	858,914,822
Tourism	190,833,160	10,388,770
Transport	3,624,363	4,149,466
Construction	197,798,325	370,837,326
Traders	9,321,867,521	8,444,608,419
Others	1,954,134,576	876,596,601
Services	5,408,976,862	3,086,907,800
	20,668,741,355	15,695,187,150

18.b Lease rental receivables

	2017	2016
Within one year from the reporting date	16,371,952	15,647,446
Deposit of rentals	-	(227,740)
Unearned income	(901,120)	(3,761,208)
	15,470,832	11,658,498
After one year but before five years from reporting date	143,325,003	143,213,782
Deposit of rentals	(48,146)	(48,146)
Unearned income	(24,539,119)	(21,547,046)
	118,737,738	121,618,590
There were no lease receivables beyond five years	-	-
Total lease rental receivables	134,208,570	133,277,088

As at 31 December
All amounts in Sri Lankan Rupees

18. Loans and advances to Customers (Continued)

18.c Movements in Individual and Collective Impairment Charges during the Year

	Individual Impairment	Collective Impairment	Total Impairment
As at 1st January 2016	186,679,152	49,996,065	236,675,217
Charge/(Write back) to income statement	40,247,663	11,238,941	51,486,604
write-off/(Recoveries) during the year	-	-	-
Exchange movement	5,685	182,139	187,824
As at 31st December 2016	226,932,500	61,417,145	288,349,645
As at 1st January 2017	226,932,500	61,417,145	288,349,645
Charge/(Write back) to income statement	149,928,724	(7,276,944)	142,651,780
write-off/(Recoveries) during the year	(1,392,068)	-	(1,392,068)
Exchange movement	2,875	19,202	-
As at 31st December 2017	375,472,031	54,159,403	429,609,357

18.d Collateral wise analysis of Loans and Advances to Customers

The Bank holds collateral against Loans and Advances to Other Customers in the form of mortgage interests over property, other registered securities over assets, and guarantees. Estimates of fair value are based on the value of collateral assessed at the time of lending, and generally are not updated except when a loan is individually assessed as impaired.

18.d.i Gross loans and advances to customers		
Individually Impaired Loans and Advances	1,069,454,068	597,912,001
Individually Significant Unimpaired Loans and Advances	18,512,349,264	13,883,546,083
Individually Non Significant Loans and Advances	1,086,938,023	1,213,729,066
	20,668,741,355	15,695,187,150
18.d.ii Individually Impaired loans and advances to customers		
Gross Amount	1,069,454,068	597,912,001
Allowance for Impairment	(375,472,031)	(226,932,500)
Carrying Amount	693,982,037	370,979,501
Collateral wise analysis of Individually Impaired Loans and Advances (Gross)		
Secured by Movable Assets	119,636,574	-
Secured by Immovable Assets	811,943,981	511,223,026
Secured by Cash	55,357,128	11,381
Other Securities	6,479,669	-
Clean	76,036,716	86,677,594
	1,069,454,068	597,912,001
Individually Significant Unimpaired		
Gross Amount	18,512,349,264	13,883,546,084
Collateral wise analysis of Individually Significant Unimpaired Loans and Advances		
Secured by Movable Assets	4,499,301,017	514,819,268
Secured by Immovable Assets	1,318,062,571	969,549,007
Secured by Cash	7,848,640,325	2,788,889,117
Other Securities	2,538,993,213	6,822,521,739
Clean	2,307,352,138	2,787,766,953
	18,512,349,264	13,883,546,084
18.d.iii Total Balance assessed under collective impairment		
Individually Significant but not impaired	18,512,349,264	13,883,546,084
Collectively assessed for impairment	1,086,938,023	1,213,729,065
	19,599,287,287	15,097,275,149
Allowance for Impairment	(54,159,403)	(61,417,145)
	19,545,127,884	15,035,858,004

As at 31 December
All amounts in Sri Lankan Rupees

	2017	2016
19. Financial Investments-Available-for-Sale		
Sri Lanka Government Securities	3,249,943,694	1,073,930,805
Unquoted Equity securities	2,030,000	2,030,000
Net Available-for-sale Investments	3,251,973,694	1,075,960,805

Assets Pledged as Securities

Government Treasury Bills amounting to Rs. 79,451,980/- (2016 : Rs. 70,777,753/-) are pledged as securities against the borrowings under Repurchase Agreements as at Reporting Date.

	2017	2016
19.1 Government of Sri Lanka - Treasury Bills		
Face value	3,325,000,000	1,130,000,000
Amortized cost	3,235,375,827	1,070,532,023
Market value	3,249,943,694	1,073,930,805
Maturity	2018	2017

19.2 Unquoted equity securities

	No. of shares	2017	2016
Lanka Clear (Private) Limited	100,000	1,000,000	1,000,000
Credit Information Bureau of Sri Lanka	300	30,000	30,000
Lanka Financial Services Bureau Limited	100,000	1,000,000	1,000,000
		2,030,000	2,030,000

20. Financial Investments- Held-to-Maturity

	Date of Maturity	2017	2016
Sri Lanka Development Bond	2018	936,695,784	916,701,579
Sri Lanka Government Securities	2017	-	1,159,791,195
Quoted Debenture			
<u>Sampath Bank</u>			
Unsecured Redeemable Debentures of Rs 100/- each	31-Dec-18	73,294,648	73,291,460
<u>NDB Bank</u>			
Unsecured Redeemable Debentures of Rs 100/- each	18-Dec-18	71,195,978	71,219,022
<u>Richard Peiris & Company PLC</u>			
Unsecured Redeemable Debentures of Rs 100/- each	12-May-17	-	44,630,325
<u>Siyapatha Finance Ltd</u>			
Unsecured Redeemable Debentures of Rs 100/- each	24-Dec-19	108,926,560	108,924,384
<u>NDB Bank</u>			
Unsecured Redeemable Debentures of Rs 100/- each	24-Jun-20	196,970,727	196,970,727
<u>Bank of Ceylon</u>			
Unsecured Redeemable Debentures of Rs 100/- each	5-Oct-20	359,012,115	359,146,240
		809,400,028	854,182,158
		1,746,095,812	2,930,674,932

As at 31 December

All amounts in Sri Lankan Rupees

21. Property, Plant and Equipment

	Freehold Land and Buildings	Leasehold Properties	Computer Hardware and Software	Office Equipment	Furniture and Fittings	Motor Vehicles	Total
Cost							
Balance as at 1st January 2016	83,702,600	78,399,948	93,636,353	47,169,789	29,456,687	32,434,253	364,799,630
Additions during the Period	-	379,940	1,755,601	374,398	300,925	-	2,810,864
Disposals during the Year		-	-	(1,666,534)	(602,678)	-	(2,269,212)
Balance as at 31st December 2016	83,702,600	78,779,888	95,391,954	45,877,653	29,154,934	32,434,253	365,341,282
Balance as at 1st January 2017	83,702,600	78,779,888	95,391,954	45,877,653	29,154,934	32,434,253	365,341,282
Additions during the Period	23,650,440	30,653,901	50,592,523	4,002,138	7,698,254	271,500	116,868,756
Disposals during the Year	-	(9,350,053)	(3,103,388)	(15,147,956)	(11,118,589)	(93,322)	(38,813,308)
Balance as at 31st December 2017	107,353,040	100,083,736	142,881,089	34,731,835	25,734,599	32,612,431	443,396,730
Accumulated Depreciation							
Balance as at 1st January 2016	4,201,356	30,374,570	79,572,296	32,156,288	20,673,030	16,061,341	183,038,881
Transfers	-	-	892,476	-	-	-	892,476
Charge for the Year	2,140,128	5,141,671	7,159,908	2,904,629	2,373,923	2,980,249	22,700,508
Disposals during the Year	-	-	-	(1,666,520)	(602,671)	-	(2,269,191)
Balance as at 31st December 2016	6,341,484	35,516,241	87,624,680	33,394,397	22,444,282	19,041,590	204,362,674
Balance as at 1st January 2017	6,341,484	35,516,241	87,624,680	33,394,397	22,444,282	19,041,590	204,362,674
Transfers	-	843,484	-	(385,738)	(947,013)	-	(489,267)
Charge for the Year	2,545,955	19,156,360	9,389,011	3,131,954	2,689,782	2,578,293	39,491,355
Depreciation on revaluation	(6,341,484)	-	-	-	-	-	(6,341,484)
Disposals during the Year	-	(9,350,036)	(3,103,363)	(15,147,853)	(11,118,524)	(74,656)	(38,794,432)
Balance as at 31st December 2017	2,545,955	46,166,049	93,910,328	20,992,760	13,068,527	21,545,227	198,228,846
Carrying Value							
As at 31st December 2016	77,361,116	43,263,647	7,767,274	12,483,256	6,710,652	13,392,663	160,978,608
As at 31st December 2017	104,807,085	53,917,687	48,970,761	13,739,075	12,666,072	11,067,204	245,167,884

(a) The cost of fully depreciated assets still in use in the Company as at 31st December 2017 was Rs. 176,165,121/- (2016 - Rs. 176,165,121/-)

(b)

	Address	Extent	Date of valuation	Market value
Land and Building (Condominium) Property at Pettah	No : 235, Fifth Cross Street , Colombo	3591 sq.ft	01 January 2017	100,000,000

The Open Market value is intended to mean the best price at which an interest in a property might reasonably be expected to be sold in the private treaty as at the date of valuation, assuming,

a). The property is prime and most suitable for high rise development.

b). Located in a prime commercial area.

If building were stated at historical cost, the carrying amounts would have been as follows;

Land & Building (Condominium)	Amount
Cost	83,702,600
Accumulated depreciation	8,434,043
Net book value	75,268,557

Fair value Hierarchy

The table below analyse non financial instruments measured at fair value at the end of the reporting period, by the level of the fair value hierarchy.

Property, Plant and Equipment	Level 1 (Rs.)	Level 2 (Rs.)	Level 3 (Rs.)	Total (Rs.)
2017	-	-	100,000,000	100,000,000

As at 31 December
All amounts in Sri Lankan Rupees

		2017	2016
22.	Intangible Assets		
	Cost		
	Balance at 01st January	103,583,833	82,772,749
	Additions during the year	39,137,663	20,811,084
	Disposals during the Year	-	-
	Balance at 31st December	142,721,496	103,583,833
	Accumulated Amortization		
	Balance at 01st January	80,865,331	74,603,805
	Transfers	-	(892,476)
	Amortization for the year	14,464,509	7,154,002
	Disposals during the Year	-	-
	Balance at 31st December	95,329,840	80,865,331
	Net Book Value	47,391,656	22,718,502
23.	Other Assets		
	Deposits and prepayments	42,952,379	71,383,138
	Sundry debtors	1,881,658	1,841,658
	Prepaid staff benefits	65,951,656	61,714,874
	Others	4,976,590	4,797,499
		115,762,283	139,737,169
24.	Due to Banks		
	Borrowings from foreign banks	2,827,825,607	2,157,626,567
	Borrowings from local banks	509,317,123	301,240,000
		3,337,142,730	2,458,866,567
25.	Deposits from customers		
	Total Deposits from customers	18,670,299,972	14,195,492,808
		18,670,299,972	14,195,492,808
a.	Product wise analysis of deposits from customers		
	Demand deposits (current accounts)	2,366,738,844	2,186,820,809
	Savings deposits	2,479,396,337	2,887,203,520
	Fixed deposits	12,958,259,654	7,928,881,500
	Certificate of deposits	228,353,967	487,621,166
	Call deposits	24,852,464	106,667,204
	Margin deposits	296,509,010	400,778,615
	Other deposits	316,189,696	197,519,994
		18,670,299,972	14,195,492,808
b.	Currency wise analysis of deposits from customers		
	Sri Lanka rupee	14,246,775,041	12,166,994,189
	United States dollar	4,091,402,378	1,604,670,819
	Great Britain pound	41,687,296	37,048,575
	Others	290,435,257	386,779,225
		18,670,299,972	14,195,492,808

As at 31 December
All amounts in Sri Lankan Rupees

26. Other borrowings

	2017	2016
Securities sold under repurchase agreements	79,451,980	70,777,753
Refinance borrowings	19,723,241	-
	99,175,221	70,777,753

27. Deferred Tax

	Asset		Liability		Net	
	31.12.2017	31.12.2016	31.12.2017	31.12.2016	31.12.2017	31.12.2016
Property, Plant and Equipment	-	-	24,347,327	22,338,502	24,347,327	22,338,502
Revaluation Gain	-	-	22,507,478	16,168,590	22,507,478	16,168,590
Asset under Finance Leases	-	-	9,744,974	6,579,540	9,744,974	6,579,540
Available for Sale Reserve	-	-	4,079,003	951,660	4,079,003	951,660
Employee Benefit obligation	22,490,333	20,052,670	-	-	(22,490,333)	(20,052,670)
Allowance for loan losses	765,814	678,635	-	-	(765,814)	(678,635)
	23,256,147	20,731,305	60,678,782	46,038,292	37,422,635	25,306,987

27.1 Reconciliation of Deferred Tax 2017

	Balance 1st Jan	Recognised in Profit or Loss	Recognised in Equity	Balance 31st Dec
Liability				
Property, Plant and Equipment	22,338,502	2,008,825	-	24,347,327
Revaluation Gain	16,168,590	-	6,338,888	22,507,478
Asset under Finance Leases	6,579,540	3,165,434	-	9,744,974
Available for Sale Reserve	951,660	-	3,127,343	4,079,003
	46,038,292	5,174,259	9,466,231	60,678,782
Assets				
Employee Benefit obligation	20,052,670	2,166,745	270,918	22,490,333
Allowance for loan losses	678,635	148,859	-	827,494
	20,731,305	2,315,604	270,918	23,317,827
	25,306,987	2,858,655	9,195,313	37,360,955

27.2 Reconciliation of Deferred Tax 2016

	Balance 01st Jan	Recognised in Profit or Loss	Recognised in Equity	Balance 31st Dec
Liability				
Property, Plant & Equipment	21,492,247	846,255	-	22,338,502
Revaluation Gain	16,168,590	-	-	16,168,590
Asset under finance leases	1,757,537	4,822,003	-	6,579,540
Available for Sale Reserve	(1,279,803)	-	2,231,463	951,660
	38,138,571	5,668,258	2,231,463	46,038,292
Assets				
Employee Benefits	17,344,990	2,487,397	220,284	20,052,670
Allowance for loan losses	361,723	316,912	-	678,635
	17,706,713	2,804,309	220,284	20,731,305
	20,431,858	2,863,949	2,011,179	25,306,987

As at 31 December *All amounts in Sri Lankan Rupees*	2017	2016
28. Other Liabilities		
Sundry creditors	7,655,347	4,672,210
Defined Benefit Obligation (Note 28.1.a)	80,322,618	71,616,680
Cheques sent on Clearing	216,407,118	307,176,064
Pay order issued	70,026,807	116,277,331
Other payables	91,177,437	99,193,976
	465,589,327	598,936,261

28.1.a Defined Benefit Obligation

	2017	2016
Opening defined benefit obligation	71,616,680	61,946,392
Movement in the present value of employee benefit liability:		
Interest cost	7,877,835	6,194,639
Current service cost	6,448,330	5,830,599
Gratuity paid during the year	(9,689,296)	(7,391,585)
Actuarial (gain) /losses	4,069,069	5,036,635
Balance as at 31 December	80,322,618	71,616,680
The expense recognised in the income statement		
Interest cost	7,877,835	6,194,639
Current service cost	6,448,330	5,830,599
	14,326,165	12,025,238
Recognised in other comprehensive income		
Net actuarial (gain)/loss recognised immediately	4,069,069	5,036,635
	4,069,069	5,036,635
Principal actuarial assumptions at the reporting date, are as follows		
Discount rate at 31 December	11%	11%
Future salary increases	10%	10%

Assumptions regarding future mortality are based on 1967/70 mortality table issued by the Institute of Actuaries, London. At present, no plan assets are held to finance the retirement benefit obligation.

Sensitivity analysis

The following table demonstrates the reasonable possible change in the key assumptions, employed with all other variables held constant in the employment benefit liability measurement.

The sensitivity of the statement of profit or loss and other comprehensive income statement of financial position, is the effect of the assumed changes in discount rate and salary increment rate as depicted below.

2017	Change In Assumption		
	Percentage	Increase	Decrease
Discount rate (change by)	1%	(3,563,033)	3,901,206
Salary increment rate (change by)	1%	4,207,159	(3,906,946)

2016	Change In Assumption		
	Percentage	Increase	Decrease
Discount rate (change by)	1%	(11,550,937)	10,797,989
Salary increment rate (change by)	1%	10,771,163	(11,580,764)

In practice this is unlikely to occur, and changes in some of the assumptions may be correlated. When calculating the sensitivity of the defined benefit obligation to significant acturial assumptions the same method (present value of thedefined benifit obligation calculated with the projected unit credit method at the end of the reproting period) has been applied when calculating the pension liability recognized within the statement if financial posotion.

As at 31 December *All amounts in Sri Lankan Rupees*	2017	2016

29. Assigned Capital

	2017	2016
Opening Balance	3,969,508,163	3,969,508,163
Capital Infusion during the year	-	-
Closing Balance	3,969,508,163	3,969,508,163

30. Reserves

Statutory Reserve Fund

	2017	2016
Opening balance at 01st January	166,818,759	144,865,180
Transfer during the period	25,184,329	21,953,579
Closing balance at 31st December	192,003,088	166,818,759

The Statutory Reserve Fund is maintained as required by the section 20 (1) of the Banking Act No. 30 of 1988. Bank appropriated 5% of the profit after tax to fulfill the minimum requirement under section 20(1) and the balance in the Statutory Reserve fund will be used only for the purposes specified in the section 20(2) of the Banking Act No 30. of 1988.

31. Commitments and Contingencies

In the normal course of business the bank makes various commitments and incurs certain contingent liabilities with legal recourse to its customers. No material losses are anticipated as a result of these transaction.

	2017	2016
Commitments		
Commitment for unutilised credit facilities	4,071,550,471	4,417,265,215
Lease commitments	161,216,749	214,274,436
Other commitments on forwards and swaps	2,875,217,433	1,523,064,231
	7,107,984,653	6,154,603,882
Contingencies		
Acceptance	2,494,849,255	1,687,574,968
Documentary credits	3,475,585,405	2,149,732,295
Guarantees	1,584,043,891	1,267,151,813
Bills sent for collection	1,434,250,379	1,979,802,269
	8,988,728,930	7,084,261,345
	16,096,713,583	13,238,865,227

32. Lease commitments

Operating lease rentals are payable as follows.

	2017	2016
Not later than one year	44,032,163	46,993,938
Later than one year and not later than five years	117,184,586	126,447,388
	161,216,749	173,441,326

As at 31st December,
All amounts in Sri Lankan Rupees

33. Analysis of Financial Assets and Liabilities by Measurement Basis

33.a As at 31 December 2017

	Available for sale	Fair Value through profit or loss	Held to Maturity	Loan and Receivable	Total
ASSETS					
Cash and Cash Equivalents	-	-	-	197,471,794	197,471,794
Balances with Central Banks	-	-	-	2,112,481,798	2,112,481,798
Placement with Banks	-	-	-	873,777,231	873,777,231
Derivative Financial Instrument	-	1,503,642	-	-	1,503,642
Loans and Advances to customers	-	-	-	20,239,109,921	20,239,109,921
Financial Investments – Available-for-Sale	3,249,943,694	-	-	-	3,249,943,694
Unquoted equity securities – Available-for-Sale (33.c)	2,030,000	-	-	-	2,030,000
Financial Investments – Held-to-Maturity	-	-	1,746,095,812	-	1,746,095,812
Total Financial Assets	3,251,973,694	1,503,642	1,746,095,812	23,422,840,744	28,422,413,892

	Fair Value through profit or loss	Other Financial Liabilities	Total
LIABILITIES			
Due to Banks	-	3,337,142,730	3,337,142,730
Derivative Financial Instrument	87,163,711	-	87,163,711
Deposits from customers	-	18,670,299,972	18,670,299,972
Other Borrowings	-	99,175,221	99,175,221
Total Financial Liabilities	87,163,711	22,106,617,923	22,193,781,634

33.b As at 31 December 2016

	Available for sale	Fair Value through profit or loss	Held to Maturity	Loan and Receivable	Total
ASSETS					
Cash and Cash Equivalents	-	-	-	203,475,398	203,475,398
Balances with Central Banks	-	-	-	1,582,860,800	1,582,860,800
Placement with Banks	-	-	-	1,570,648,609	1,570,648,609
Derivative Financial Instrument	-	10,387,471	-	-	10,387,471
Loans and Advances to customers	-	-	-	15,406,837,505	15,406,837,505
Financial Investments – Available-for-Sale	1,073,930,805	-	-	-	1,073,930,805
Unquoted equity securities – Available-for-Sale (33.c)	2,030,000	-	-	-	2,030,000
Financial Investments – Held-to-Maturity	-	-	2,930,674,932	-	2,930,674,932
Total Financial Assets	1,075,960,805	10,387,471	2,930,674,932	18,763,822,312	22,780,845,520

	Fair Value through profit or loss	Other Financial Liabilities	Total
LIABILITIES			
Due to Banks	-	2,458,866,567	2,458,866,567
Derivative Financial Instrument	549,854	-	549,854
Deposits from customers	-	14,195,492,808	14,195,492,808
Other Borrowings		70,777,753	70,777,753
Total Financial Liabilities	549,854	16,725,137,128	16,725,686,982

33.c These investments are stated at cost as it was impractical to compute the market value due to unavailability of market information. However, Management has determined the impact as immaterial as it was less than 0.01 % of the total assets.

33.d Fair value hierarchy for assets carried at fair value

The table below analyses financial investments measured at fair value at the end of the reporting period, by the level of the fair value hierarchy.

31 December 2017	Level 1	Level 2	Level 3	Total
Financial Assets				
Derivative financial instruments				
Currency swaps	-	1,499,865	-	1,499,865
Forward foreign exchange contracts	-	3,777	-	3,777
	-	1,503,642	-	1,503,642
Financial Investments available for sale				
Government of Sri Lanka treasury bills	3,249,943,694	-	-	3,249,943,694
	3,249,943,694	-	-	3,249,943,694
Financial Liabilities				
Derivative financial instruments				
Currency swaps	-	87,163,711	-	87,163,711
Forward foreign exchange contracts	-	-	-	-
	-	87,163,711	-	87,163,711
31 December 2016				
Financial Assets				
Derivative financial instruments				
Currency swaps	-	8,351,398	-	8,351,398
Forward foreign exchange contracts	-	2,036,073	-	2,036,073
	-	10,387,471	-	10,387,471
Financial Investments available for sale				
Government of Sri Lanka treasury bills	1,073,930,805	-	-	1,073,930,805
	1,073,930,805	-	-	1,073,930,805
Financial Liabilities				
Derivative financial instruments				
Currency swaps	-	339,933	-	339,933
Forward foreign exchange contracts	-	209,921	-	209,921
	-	549,854	-	549,854

33.e Fair value of Financial Instruments carried at amortised cost

Set out below is a comparison, by class, of the carrying amounts and fair values of the bank's financial assets and liabilities that are not carried at the fair value in the financial statements. The fair values in the table below may be different from the actual amounts that will be received/paid on the settlement or maturity of the financial instrument. For certain instruments, the fair value may be determined using assumptions for which no observable prices are available.

As at 31 December	2017	
	Carrying amount	Fair value
Assets	Rs.	Rs.
Cash and Cash Equivalents	197,471,794	197,471,794
Balances with Central Banks	2,112,481,798	2,112,481,798
Placements with Banks	873,777,231	873,777,231
Loans and receivables to other customers	20,239,109,921	20,297,752,749
Financial Investments – Held to maturity	1,746,095,812	1,746,095,812
Liabilities		
Due to Banks	3,337,142,730	3,337,142,730
Due to Other Customers	18,670,299,972	18,670,299,972
Other Borrowings	99,175,221	99,175,221

Given below is the basis adopted by the Bank in order to establish the fair values of the financial instruments which are shown above.

Cash and cash equivalents ,balances with central banks and placements with banks
The carrying amounts of cash and cash equivalents, balances with central banks and placements with banks approximate their fair value as those are short-term in nature. These balances have a contractual remaining maturity of less than three months from the reporting date.

Loans and advances to other customers

More than 87% of the total portfolio of loans and advances to other customers have a remaining contractual maturity of less than one year.

The fair value of loans and advances to other customers with a residual maturity of less than one year generally approximates the carrying value, subject to any significant movement in credit spreads.

The estimated fair value of loans and advances with a residual maturity of more than one year is the present value of future cash flows expected to be received from such loans and advances calculated based on interest rates at the reporting date for similar types of loans and advances. Such loans include both fixed and floating rate loans. Majority of the floating rate loans can be re priced either quarterly or semi annually while for fixed rate loans, the loan contract allows the Bank to change the contracted rate if there is a material difference between the contracted rate and the market interest rate.
The Bank calculated the fair value of the term loans and leasing portfolio with a fixed interest rate and that will have a maturity of more than 12 months from the reporting date. Fair value of term loans and leasing portfolio as at 31st December 2017 was Rs 2,524.6 Mn and 95.1 Mn as against its carrying value which amounted to Rs 3,058.4 Mn and 118.7 Mn respectively.

Financial Investments - Held to Maturity
Financial investments -Held to maturity include investments in Sri Lanka Development Bonds, debentures and Commercial Papers.

All Sri Lanka Development Bonds are variable rate instruments where repricing happens semi annually. Thus, the carrying value of these bonds approximate to their fair value as at the reporting date. The carrying value of debentures and commercial papers also approximate to their fair value at reporting date.

Due to Banks

All amounts due to other banks as at the reporting date have a remaining contractual maturity of less than three months. Therefore fair value of amounts due to banks approximate to the carrying value as at the reporting date.

Due to other customers
Almost 100% of the customer deposits are either repayable on demand or have a remaining contractual maturity of less than one year. Customer deposits with a contractual maturity of more than one year are subject to pre mature upliftment. Amounts paid to customers in the event of pre mature upliftment would not be materially different to its carrying value as at date. Therefore fair value of customer deposits approximates to their carrying value as at the reporting date.

Other Borrowings
Other borrowings mainly consist of securities sold under repurchase agreements which have a remaining contractual maturity of less than three months. Accordingly, carrying value of these borrowings would not be materially different to their fair values as at the reporting date.

As at 31st December 2017

34 (i) Maturity Analysis of Assets and Liabilities

(a) An analysis of the total assets of the Bank as at 31st December 2017 based on the remaining period as at the reporting date to the respective contractual maturity dates is given below:

	Carrying Amount	Derivative Financial Instruments	Up to 3 Months	3 to 12 Months	1 to 3 Years	3 to 5 Years	More than 5 Years	Unallocated	Total as at 31/12/2017
	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.
Interest bearing assets									
Placement with banks	741,985,780	-	741,985,780	-	-	-	-	-	741,985,780
Loans and receivables to other customers	20,239,109,921	-	13,625,043,674	3,946,184,036	1,956,792,355	636,908,914	73,672,797	-	20,238,601,776
Financial investments – Available-for-sale	3,249,943,694	-	906,078,613	2,343,865,081					3,249,943,694
Financial Investments – Loans and Receivables	1,746,095,812	-	936,695,784	144,490,626	664,909,402	-	-	-	1,746,095,812
Non Interest bearing assets									
Cash and cash equivalents	197,471,794	-	197,471,794						197,471,794
Balances with central banks	2,112,481,798	-	2,112,481,798						2,112,481,798
Placement with banks	131,791,451	-	131,791,451						131,791,451
Derivative financial instrument	1,503,642	1,503,642							1,503,642
Financial investments – Available-for-sale	2,030,000	-	-	-	-	-	2,030,000	-	2,030,000
Property, plant and equipment	245,167,884	-	-	-	-	-	-	245,167,884	245,167,884
Intangible assets	47,391,656	-	-	-	-	-	-	47,391,656	47,391,656
Other assets	115,762,283	-	115,762,283	-	-	-	-	-	115,762,283
Total Assets	28,830,735,715	1,503,642	18,767,311,177	6,434,539,743	2,621,701,757	636,908,914	75,702,797	292,559,540	28,830,227,569
Interest bearing liabilities									
Due to banks	3,337,142,730	-	3,337,142,730	-	-	-	-	-	3,337,142,730
Derivative financial instrument	87,163,711	87,163,711	-	-	-	-	-	-	87,163,711
Due to other customers	15,690,862,422	-	11,330,106,921	4,295,434,379	29,010,049	36,311,073	-	-	15,690,862,422
Other borrowings	99,175,221	-	99,175,221	-	-	-	-	-	99,175,221
Non Interest bearing liabilities									
Due to other customers	2,979,437,550	-	2,979,437,550	-	-	-	-	-	2,979,437,550
Current tax liabilities	106,453,518	-	-	106,453,518	-	-	-	-	106,453,518
Deferred tax liabilities	37,360,954	-	-	37,360,954	-	-	-	-	37,360,954
Other liabilities	465,589,327	-	465,589,327	-	-	-	-	-	465,589,327
	22,803,185,433	87,163,711	18,211,461,748	4,439,248,851	29,010,049	36,311,073	-	-	22,803,185,433
Interest rates sensitivity Gap	6,027,550,282	(85,660,069)	555,859,429	1,995,290,892	2,592,691,708	600,597,841	75,702,797	292,559,540	6,027,042,137

As at 31st December 2016

34 (ii) Maturity Analysis of Assets and Liabilities

(a) An analysis of the total assets of the Bank as at 31st December 2016 based on the remaining period as at the reporting date to the respective contractual maturity dates is given below:

	Carrying Amount	Derivative Financial Instruments	Up to 3 Months	3 to 12 Months	1 to 3 Years	3 to 5 Years	More than 5 Years	Unallocated	Total as at 31/12/2016
	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.
Interest bearing assets									
Placement with banks	1,157,723,607	-	1,157,723,607	-	-	-	-	-	1,157,723,607
Loans and receivables to other customers	15,406,837,505	-	12,006,902,135	1,559,545,609	1,126,478,629	636,908,913	77,002,219	-	15,406,837,505
Financial investments – Available-for-sale	1,073,930,805	-		1,073,930,805					1,073,930,805
Financial Investments – Loans and Receivables	2,930,674,932	-	-	1,204,421,520	1,061,212,061	665,041,351	-	-	2,930,674,932
Non Interest bearing assets									
Cash and cash equivalents	203,475,398	-	203,475,398						203,475,398
Balances with central banks	1,582,860,800	-	1,582,860,800						1,582,860,800
Placement with banks	412,925,002	-	412,925,002						412,925,002
Derivative financial instrument	10,387,471	10,387,471							10,387,471
Financial investments – Available-for-sale	2,030,000	-	-	-	-	-	2,030,000	-	2,030,000
Property, plant and equipment	160,978,608	-	-	-	-	-	-	160,978,608	160,978,608
Intangible assets	22,718,502	-	-	-	-	-	-	22,718,502	22,718,502
Other assets	139,737,169	-	139,737,169	-	-	-	-	-	139,737,169
Total Assets	23,104,279,799	10,387,471	15,503,624,111	3,837,897,934	2,187,690,690	1,301,950,264	79,032,219	183,697,110	23,104,279,799
Interest bearing liabilities									
Due to banks	2,458,866,567	-	2,458,866,567	-	-	-	-	-	2,458,866,567
Derivative financial instrument	549,854	549,854	-	-	-	-	-	-	549,854
Due to other customers	11,410,373,390	-	9,151,044,238	2,212,179,442	25,533,184	21,616,527	-	-	11,410,373,391
Other borrowings	70,777,753	-	-	70,777,753	-	-	-	-	70,777,753
Non Interest bearing liabilities									
Due to other customers	2,785,119,418	-	2,785,119,418	-	-	-	-	-	2,785,119,418
Current tax liabilities	115,962,120	-	-	115,962,120	-	-	-	-	115,962,120
Deferred tax liabilities	25,306,986	-	-	25,306,986	-	-	-	-	25,306,986
Other liabilities	598,936,261	-	598,936,261	-	-	-	-	-	598,936,261
	17,465,892,349	549,854	14,993,966,484	2,424,226,301	25,533,184	21,616,527	-	-	17,465,892,350
Interest rates sensitivity Gap	5,638,387,450	9,837,617	509,657,627	1,413,671,633	2,162,157,506	1,280,333,737	79,032,219	183,697,110	5,638,387,449

As at 31 December
All amounts in Sri Lankan Rupees

35 Related Party Disclosures

The Bank carries out transactions in the ordinary course of its business with parties who are defined as related parties in Sri Lanka Accounting Standard(LKAS 24) "Related Party Disclosures", the details of which are reported below.

35.1 Transactions with Key Management Personnel (KMP)

According to Sri Lanka Accounting Standard 24 "Related Party Disclosures", Key Management Personnel are those having authority and responsibility for planning, directing and controlling the activities of the entity. Accordingly, the Senior Managers of the Bank have been classified as KMP of the Bank.

35.1.a Compensation of KMPs	2017	2016
Short term employment benefits	74,301,188	64,317,770
Post employment benefits	4,648,940	3,930,622
	78,950,128	68,248,392

35.1.b Transactions with KMPs

Statement of Financial Position items	2017	2016
Assets		
Loans & advances	6,749,845	10,798,491
Liabilities		
Deposits	4,589,234	244,241

35.1.c Direct & Indirect Accommodation

	2017	2016
Direct & indirect accommodation as % of the Bank's regulatory capital	0.11%	0.19%

35.2 Transaction with Other Related Parties

In addition to transactions with key management, the bank enters into transactions with entities with significant influence over the bank. The following table shows the outstanding balance and the corresponding interest during the year.

35.2.a

Group - Related Party	Nature of the transaction	2017 Rs.	2016 Rs.
MCB Pakistan	Overseas borrowing	-	753,100,000
	Vostro balances	41,755,657	13,026,615
	Nostro balance	12,649,826	20,318,969
	Interest expense	14,638,212	31,170,652
MCB Bahrain	Overseas borrowing	768,750,000	-
	Nostro Balance	953,099	35,926
	Deposit	406,207,500	-
	Interest expense-Borrowing	13,001,591	-
	Interest expense- Deposit	5,169,690	-
MCB Leasing CJSC Azerbaijan	Lending	408,219,279	-
	Deposit	5,096,659	-
	Interest Income	2,751,748	-
	Interest expense	-	-
MCB Dubai	Overseas borrowing	-	-
	Interest expense	-	-

35.2.b Direct and Indirect Accommodation

	2017	2016
Direct and indirect accommodation as % of the Bank's regulatory capital	0%	0%

The above mentioned outstanding balances arose from the ordinary course of business. The interest charged to and by related parties are at normal commercial rates.

35.3 Transaction with Post Employment Benefit of the Bank

Name of the Related Party	Nature of the transaction	2017	2016
MCB Bank Sri Lanka Branch	Deposits	90,619,601	83,471,299
Staff Provident fund	Repurchase agreements	75,000,000	68,000,000
	Interest expenses	6,994,110	11,274,352
	Contribution made	17,409,750	13,461,156

For the year ended 31 December 2017

36 Events Occurring after the Reporting Date

No material events have arisen since the reporting date which require adjustment or disclosure in financial statements.

37 Litigations & Claims

In the opinion of the Management, there are no pending litigations against the company that will have a material impact on the reported financial results or the future operations of the company.