

Reports of Directors

Committee Reports

Audit Committee Report

The purpose of the Audit Committee is to assist the Board in its general oversight of financial reporting, internal controls and audit functions. The composition requirements and the terms of reference of the Audit Committee are set out in the Direction No. 12 of 2007 on Corporate Governance for Licensed Specialised Banks in Sri Lanka issued by the Central Bank of Sri Lanka (hereinafter referred to as the Direction). This is complementary to the charter formulated by the Audit Committee.

This report provides information on the compliance with regulatory requirements and where appropriate the process adopted by the Audit Committee to discharge their responsibilities.

The Composition of the Committee

All members of this Committee are Non-Executive Directors and the Chairman of the Committee and Mr S N P Palihena qualify as Independent Directors as per the criteria given in Rule No. 3(2) (iv) of the Direction. The Chairman is a Chartered Accountant with considerable experience in the fields of Finance and Audit. The profiles of the members of the Committee are given elsewhere in the Annual Report.

The composition of the Committee as at the date of this report is as follows:

- Mr T K Bandaranayake (*Chairman*)
- Mr S N P Palihena
- Mr D S Weerakkody

Mr T K Bandaranayake served as an adviser to the Committee until 23 October 2009 subsequent to which he became a Non-Executive Independent Director and a member of the Committee.

Mr A M de S Jayaratne, a Non-Executive Independent Director was the Chairman of the Committee until 30 April 2010 on which date he retired from the Board of Directors as required by the Direction on reaching the age of 70 years.

The Bank has complied with Rule No. 3(6)(ii) of the composition of the Audit Committee and its terms of reference.

The Head of Internal Audit of the Bank retired in November 2009. The new Head was appointed and assumed duties in January 2010 after the Audit Committee approved his appointment. The new Head of Internal Audit has extensive experience in commercial banking and is responsible for the Internal Audit functions of the Bank and its commercial banking subsidiary, DFCC Vardhana Bank Limited and is designated as Head of Group Internal Audit. He holds the management rank of Vice-President and serves as the

Secretary of the Committee. He has direct access to the members of the Audit Committee.

Meetings

During the financial year ended 31 March 2010, eight Audit Committee Meetings were held. Minutes of the Audit Committee Meetings are reported regularly to the Board.

Attendance by the Committee members at meetings is given in the table on page 27 of the Annual Report.

The Chief Executive and Executive Vice-President (Finance) attend the meetings by invitation. The Committee met with the external auditor, KPMG Ford, Rhodes, Thornton & Company on 31 August 2009 and 16 December 2009 without any Executive being present so as to provide the External Auditor an opportunity to have a frank dialogue with the Committee.

Role of the Audit Committee

The Audit Committee assists the Board of Directors in fulfilling its oversight responsibilities for the Bank's accounting and financial reporting process and audit of the financial statements of the Bank by monitoring - (1) the integrity of

the Bank's financial statements, (2) the independence and qualifications of its External Auditor, (3) the Bank's system of internal controls, (4) the performance of the Bank's internal audit process and External Auditor, and (5) the Bank's compliance with Laws, Regulations and Codes of Conduct, with a view to safeguarding the interests of all stakeholders of the Bank.

Financial Reporting

The Committee assists the Board of Directors to discharge their responsibility for the preparation of true and fair financial statements in accordance with the books of accounts and Sri Lanka Accounting Standards by (1) reviewing the adequacy and effectiveness of the internal control system and procedures to provide reasonable assurance that all transactions are accurately and completely recorded in the books of accounts, (2) reviewing the integrity of the process by which financial statements are derived from the books of accounts, (3) reviewing the choice of appropriate accounting policies and the judgments made in the application of such accounting policies, (4) reviewing the process by which compliance with Sri Lanka Accounting Standards and other regulatory provisions relating to financial statements are ensured with reasonable degree of assurance.

The Committee reviewed all quarterly non-audited interim financial statements and financial statements for the year ended 31 March 2010 together with supporting information that included significant assumptions and judgments made in the preparation of financial statements. The committee also took into consideration the internal audit reports, management letter issued by

the External Auditor, compliance reports and the responsibility statements in relation to the financial statements issued by the Chief Financial Officer and Chief Executive Officer in making an overall assessment on the integrity of the financial reporting system.

The Committee confirms that to the best of its knowledge and belief the financial reporting system of the Bank has been designed to provide reasonable assurance on the reliability of the financial statements prepared for external purposes and is in compliance with relevant accounting principles and regulatory requirements. The accounting principles are based on relevant Sri Lanka Accounting Standards, and regulatory requirements including DFCC Bank Act No. 35 of 1955, Banking Act No. 30 of 1988 and Companies Act No. 7 of 2007 as applicable to the Bank.

Internal Audit and Inspection

With the concurrence of the Board, the Audit Committee has continued to engage the services of a firm of Chartered Accountants to supplement the Bank's internal audit function in carrying out periodic audits at some of the business units. Representatives from the audit firm are invited to the Audit Committee Meetings convened to discuss their reports.

The Audit Committee also provides a forum for the review of internal audit reports and consideration of findings, recommendations and corrective action taken by management to overcome

the deficiencies identified, with a view to managing significant business risks and improving controls. Department/ Unit heads attend meetings when their reports are discussed. Management is required to implement the recommendations contained in internal audit reports unless dispensation is given by the Committee. Such dispensations are infrequent.

Risks and Controls

The Committee has adopted a risk-grading matrix for identifying and assessing risks identified during audits. The Committee seeks and obtains the required assurance from the head of the business unit on the remedial action taken in order to maintain the effectiveness of internal controls.

External Audit

The Audit Committee assists the Board of Directors to implement a transparent process - (1) in the engagement and remuneration of the External Auditor for audit services with the approval of the shareholders, (2) in reviewing the non-audit services to ensure that they do not lead to impairment of the independence of the Auditor, (3) in assisting the Auditor to complete the audit programme within an agreed time frame in compliance with relevant guidelines issued by the Central Bank of Sri Lanka.

In order to discharge its responsibilities the Audit Committee meets with the Auditor as and when it is necessary. During this meeting with the Auditor the Audit Committee - (1) reviews the non-audit services provided by the External Auditor to ensure that provision of such services are not in conflict with the guidelines issued by the Central Bank of

Sri Lanka and that the remuneration for such services are not of such value so as to impair their independence, (2) obtains information relating to the total remuneration of the External Auditor for audit and non-audit services provided to the Bank and the Group, (3) discusses and finalises the scope of the audit to ensure that it is in compliance with the guidelines issued by the Central Bank of Sri Lanka.

In the context of determining the independence of the Auditor, the Committee reviewed the statements issued by the External Auditor pursuant to Section 163(3) of the Companies Act No. 07 of 2007. As per this declaratory statement the Auditor has confirmed that they do not have any relationship that would impair their independence and disclosed the total remuneration for the financial year ended 31 March 2010 for both audit and permitted non-audit services.

The Audit Committee also meets with the Auditor at the conclusion of the audit to review the Management Letter issued by the Auditor before it is transmitted to the Board of Directors and the Central Bank of Sri Lanka.

Regulatory Compliance

The Bank's procedures in place to ensure compliance with mandatory banking and statutory requirements were under constant check. The Committee is satisfied that the Bank substantially complies with these requirements. With regard to its continuing investment in Commercial Bank of Ceylon PLC, the Bank has

not as yet reduced its shareholding to 15% as directed by the Central Bank of Sri Lanka, but has complied with the consequential provision whereby its voting rights are restricted to 10% until such reduction takes place. This matter is sub-judice.

Rule No. 3(8)(ii) (c) and (g) of the direction requires External Auditors certification on the effectiveness of the internal control mechanism and compliance with the provisions of the Corporate Governance to be published in the Annual Report. This certification is intended to be an independent validation of the affirmative assurances provided by Directors on this subject. The External Auditor, KPMG Ford, Rhodes, Thornton & Company, however has informed that they cannot consent to the publication of any such report given by them in the absence of an appropriate framework issued by The Institute of Chartered Accountants of Sri Lanka, which is still under preparation. Under the circumstances, in common with other banks who have published their Annual Reports, it has not been possible for the Bank to comply with this regulatory requirement.

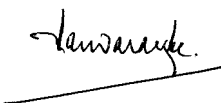
Evaluation of the Committee

An evaluation of the effectiveness of the Committee was carried out by the other members of the Board and the Committee has been found to be effective.

Reappointment of Auditor

The Audit Committee having evaluated the quality of audit service provided by the current Auditor has recommended to the Board of Directors that M/s KPMG Ford, Rhodes, Thornton & Company be reappointed as Auditors for the year ending 31 March 2011, subject to the approval of shareholders at the Annual General Meeting.

The Chairman and the members of the Committee wish to place on record their appreciation of invaluable contribution made by Mr A M de S Jayaratne as the previous Chairman of the Audit Committee until his retirement.



T K Bandaranayake
Chairman - Audit Committee

26 May 2010

Reports of Directors

Committee Reports

Human Resources and Remuneration Committee Report

The Human Resources and Remuneration Committee appointed by the Board of Directors, consists of three Non-Executive Directors. Mr J M S Brito is the Chairman of the Committee and Messrs C P R Perera and D Weerakkody act as members. The Chief Executive - Mr. Nihal Fonseka attended meetings by invitation and participated in its deliberations except when his own evaluation and remuneration was under discussion. The former Executive Vice-President, Special Loans Administration & Human Resources and the Group Vice-President, Human Resources assisted the Committee by providing relevant information.

The Committee has adopted as its mandate the tasks specified in Section 3 (6) (iii) and Direction No. 12 of 2007 of the Central Bank of Sri Lanka on Corporate Governance for licensed specialised banks. The Committee determines the remuneration policy relating to Directors, Chief Executive Officer and Key Management Personnel of the Bank. In determining the appropriate compensation levels, the Committee recognises the need for the Bank to attract, retain and motivate talent with the core capabilities matched

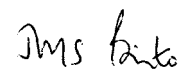
to its strategy and needs to ensure the Bank consistently delivers value to all stakeholders and make the organisation more competitive. With this in mind the Committee uses a mixture of fixed and variable pay to reward employees.

Consistent with the Bank's policy of pay for performance, the committee reviewed the performance of the Bank for determining and recommending to the board the annual salary pool and the bonus pool for the Bank. The Committee also appraised the performance of the Chief Executive Officer against the pre-agreed targets and made recommendations to the board with regard to the CEOs total remuneration.

In addition, the Committee considers and recommends to the Board of Directors from time to time, the requirements of additional/new expertise/skills. Further, the Committee assesses and recommends to the Board on all promotions of Key Management Personnel and the basis for rewarding them. They also review periodically

the Bank's Talent Pool to identify high potential and review and approve the succession plans in place for all critical management positions in the Bank.

The Committee held five meetings during the financial year to carry out its task. The attendance by members is given in page 27 of the Annual Report.



J M S Brito
Chairman - Human Resources and Remuneration Committee

26 May 2010

Reports of Directors

Committee Reports

Nominations Committee Report

The Composition

The Nomination Committee of the Board of Directors consist of three Non-Executive Directors. Mr C P R Perera, an independent Director is the Chairman with Messrs J M S Brito and D S Weerakkody serving as members. The Chief Executive, Mr A N Fonseka attends meetings by invitation, while the Secretary to the Board functions as the Secretary of the Committee.

The Mandate

The Committee carries out the tasks set out in Section 3 (6) (iv) of Direction No. 12 of 2007 issued by the Central Bank of Sri Lanka and Corporate Governance in licensed specialised Banks. In terms of this Direction the committee identifies and evaluates persons with the required skills, knowledge, standing, fitness and propriety to join the Board of the Bank and evaluate the suitability of Directors seeking re-election. The Committee is also tasked with the responsibility of a putting in place a procedure for the appointment of the CEO and Key Management Personnel, when necessary. The Committee makes recommendations to the Board for consideration.

The Procedure

The Committee meets when required and acts within a framework approved by the Board of Directors when making its recommendations. The framework incorporates, inter alia, the requirements of Direction No 12 of 2007 of the Central Bank and the Listing Rule 7.10 of the Colombo Stock Exchange relating to Corporate Governance.

Meetings

Four meetings were held during the financial year to identify possible candidates to fill Board vacancies and to assess the fitness and propriety of Directors. The attendance by Directors at meetings is given in page 27 of the Annual Report. All appointments made to the Board were recommended by the Committee.



C P R Perera
Chairman - Nominations Sub-committee

26 May 2010

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Board Integrated Risk Management Committee Report

Composition of Board Integrated Risk Management Committee

The Board Integrated Risk Management Committee (BIRMC) of DFCC consisted of 3 Non-Executive Directors and 5 Non-Voting members, as at 31 March 2010. The Head of Internal Audit, Mr A G N Bandara, attends meetings by invitation while the Chief Risk Officer, Mr S de Silva, functions as the Secretary to the Committee

Mr J M S Brito - *Chairman*

Mr S N P Palihena - *Non-Executive Director*

Mr A S Abeyewardene - *Non-Executive Director*

Mr A N Fonseka - *Chief Executive/ Ex-Officio Director*

Mr H A Ariyaratne - *Executive Vice-President/Lending*

Mr S Nagarajah - *Executive Vice-President/Finance*

Ms A Withane - *Executive Vice-President/Operations*

Mrs M Gunewardena - *Executive Vice-President/Treasury & Resource Development*

Charter and the Responsibilities of the BIRMC

The approved Charter for the BIRMC stipulates authority, structure, responsibilities and tasks of BIRMC.

As per its Charter, the primary responsibilities of BIRMC are to review and ensure:

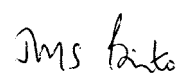
- Integrity and adequacy of the risk management function of the Bank
- Adequacy of the Bank's capital on a solo and consolidated basis and its allocation
- Risk exposures and risk profiles of the Bank and its subsidiaries are within acceptable parameters and to make recommendations to the Board of Directors on any action required
- The compliance of the Bank's operations with relevant laws, regulations and standards including the adherence to the Direction on Corporate Governance issued by the Central Bank

The Integrated Risk Management Department prepares and collates the material necessary for the BIRMC to deliberate and take decisions on matters falling within its mandate or to make considered recommendations to the Board. These are circulated to members

in advance. The process through which Risks were managed is explained in detail in the Management Discussion section of this Annual Report.

BIRMC Meetings

BIRMC meets on a quarterly basis. During the year, DFCC Bank convened four BIRMC meetings. The attendance of Directors in the Committee is listed on page 27 of the Annual Report. The minutes of the meetings are reported to the Board subsequently. The committee reviewed policy frameworks, risk management strategies. Risk limits and key risk indicators at these meetings and was satisfied that the risk exposures of the Bank were being satisfactorily managed.



J M S Brito
Chairman

26 May 2010